Supreme Court, U.S.
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No.

IN THE
**SUPREME COURT OF THE UNITED STATES**
OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,

*Petitioner,*

v.

MANUEL KAPLAN, CAROL KAPLAN and M.K. INVESTMENTS, INC.,

*Respondents.*

# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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September 27, 1994

## QUESTIONS PRESENTED

1. Whether a court reviewing an arbitration award under the Federal Arbitration Act should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits when reviewing the arbitrators' decision on arbitrability where the party objecting to arbitral jurisdiction had submitted the issue to the arbitrators for decision, as to which the courts of appeal are in conflict.

2. Whether the United States Courts Of Appeals should apply a *de novo* or an abuse-of-discretion standard of appellate review to a district court's decision denying a petition to vacate an arbitration award and granting a cross-petition to confirm an award, as to which the courts of appeal are in conflict.

3. Whether an "associated person" of a member of the Philadelphia Stock Exchange -- as defined in the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(21) (1988), and the rules of the Exchange -- is subject to the arbitral jurisdiction of the Exchange in a dispute between a member of the Exchange and the "associated person".

**TABLE OF CONTENTS**

QUESTIONS PRESENTED ..... i

TABLE OF CONTENTS ..... ii

TABLE OF AUTHORITIES ..... iv

OPINIONS BELOW ..... 2

JURISDICTION ..... 2

STATEMENT OF THE CASE ..... 3

REASONS FOR GRANTING THE WRIT ..... 9

Summary of Argument ..... 9

I. There Is A Conflict Among The Circuits Regarding The Standard Of Review To Be Afforded To Arbitrators' Decisions On Arbitral Jurisdiction, Where The Parties Have Presented The Issue Of Arbitrability To The Arbitrators For Determination. ..... 10

II. The Circuits Are In Conflict As To Whether A Court of Appeals Should Apply An Abuse-Of-Discretion Standard Or A *De Novo* Standard When Reviewing A District Court's Order Denying A Petition To Vacate, Or Granting A Petition To Confirm, An Arbitration Award. ..... 18



III. In A Matter Of Great Public Importance, The Third Circuit Erroneously Held That, Absent Some Additional Evidence Of Consent To Arbitrate, An "Associated Person" Of An Exchange Member Is Not Compelled To Arbitrate A Dispute With An Exchange Member, Despite An Exchange Rule To The Contrary. ..... 21

A. The Holding of The Court of Appeals ..... 22

B. The Court of Appeals' Holding Misconstrues Applicable Case Law And The Purposes Underlying Exchange-Based Arbitrations Between Members And Associated Persons ..... 26

CONCLUSION ..... 30

## TABLE OF AUTHORITIES

**Cases:** **Page**

AT&T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643 (1986) ..... 13

Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988) ..... 18

Brennan v. Stanford, 600 N.E.2d 404 (Ill. App. 1st Dist. 1992), app. denied, 610 N.E.2d 1260 (Ill. 1993) ..... 27, 29

Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos, 25 F.3d 223 (4th Cir. 1994) ..... 12

Colonial Indemn. Ins. Co. v. Omaha Indem. Co., 943 F.2d 327 (3d Cir. 1991) ..... 18

Creative Securities Corp. v. Bear Stearns & Co., 671 F. Supp. 961 (S.D.N.Y. 1987) ..... 26, 29

Davis v. Chevy Chase Financial Limited, 667 F.2d 160 (D.C. Cir. 1981) ..... 12

Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985) ..... 13

Fleck v. E.F. Hutton Group, Inc., 891 F.2d 1047 (2d Cir. 1989) ..... 26, 29

Forsythe Int'l S.A. v. Gibbs Oil Co., 915 F.2d 1017 (5th Cir. 1990) ..... 21



Franklin Electric Co. v. International Union, 886 F.2d 188 (8th Cir. 1989) ..... 11

Freight Drivers v. Kingsway Transports, Inc., 1992 WL 281379 (W.D.N.Y. Aug. 31, 1992) ..... 15

GK MGT Inc. v. Local 274, Hotel Employees and Restaurant Employees Union, AFL-CIO, 930 F.2d 301 (3d Cir. 1991) ..... 11

Geldermann, Inc. v. Stathis, 532 N.E.2d 366 (Ill. App. 1st Dist. 1988) ..... 27, 29

George Day Constr. Co. v. United Brotherhood of Carpenters, 722 F.2d 1471 (9th Cir. 1984) .....11, 14-15, 16

Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp., 650 F. Supp. 222 (N.D. Ga. 1986) ..... 26, 27, 28, 29

International Association of Machinists v. Fansteel, Inc., 900 F.2d 1005 (7th Cir. 1990), cert. denied, 498 U.S. 851 (1990) ..... 15-16

International Association of Machinists v. General Electric Co., 865 F.2d 902 (7th Cir. 1989) ..... 12

International Brotherhood of Teamsters, Local 249 v. Western Pennsylvania Motor Carriers Association, 574 F.2d 783 (3d Cir.), cert. denied, 439 U.S. 828 (1978) ..... 8

Interstate Brands Corp. v. Chauffeurs, Teamsters, Warehousemen & Helpers Local Union No. 135, 909 F.2d 886 (6th Cir. 1990), cert. denied, 499 U.S. 905 (1991). ..... 11

Johnson v. United Food & Comm. Workers, 828 F.2d 961 (3d Cir. 1987) ..... 12

Local 369 v. Boston Edison Co., 752 F.2d 1 (1st Cir. 1984) ..... 10

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) ..... 13, 25

Mobil Oil Corp. v. Local 8-766, 600 F.2d 322 (1st Cir. 1979) ..... 10

Moseley, Hallgarten Estabrook & Weeden v. Ellis, 849 F.2d 264 (7th Cir. 1988) ..... 19

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983) ..... 13, 25

Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co., 868 F.2d 52 (3d Cir. 1989) ..... 18

New York Hotel & Motel Trades Council, AFL-CIO v. Hotel Nikko of New York, inc., 1991 WL 168284 (S.D.N.Y. Aug. 22, 1991) ..... 15

Pennsylvania Power Co. v. Local Union No. 272, 886 F.2d 46 (3d Cir. 1989) ..... 12

RM Perez & Assocs. v. Welch, 960 F.2d 534 (5th Cir. 1992) ..... 19

Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410 (11th Cir. 1990) ..... 18

Robbins v. Day, 954 F.2d 679 (11th Cir.), cert. denied sub nom. Robbins v. PaineWebber, Inc., 113 S. Ct. 201 (1992) ..... 7, 18, 19, 20, 21, 22



Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989) ..... 13

Schmidt v. Finberg, 942 F.2d 1571 (11th Cir. 1991) ..... 18

Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987) ..... 13, 24

Southland Corp. v. Keating, 465 U.S. 1 (1985) ..... 13

Swink & Co. v. Hereth, 784 F.2d 866 (8th Cir. 1986) ..... 26, 28

United Industrial Workers v. Government of the Virgin Islands, V.I., 987 F.2d 162 (3d Cir. 1993) ..... 11

United Steelworkers of America v. American Smelting & Refining Co., 648, F.2d 863 (3d Cir. 1981), cert. denied, 454 U.S. 1031 (1981) ..... 12

United Steelworkers of America v. Warrior & Gulf Nav. Co., 363 U.S. 574 (1960) ..... 13

United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960) ..... 14

Vic Wertz Distributing co. v. Teamsters Local 1038, 898 F.2d 1136 (6th Cir. 1990) ..... 11

Volt Information Sciences, Inc. v. Board of Trustees, 489 U.S. 468 (1989) ..... 13

Walck v. American Stock Exchange, Inc., 687 F.2d 778 (3d Cir. 1982), cert. denied, 461 U.S. 942 (1983) ..... 24

Wilkes-Barre Publishing Co. v. Newspaper Guild of Wilkes-Barre, 647 F.2d 372 (3d Cir. 1981), cert. denied, 454 U.S. 1143 (1982) ..... 16

**Statutes:**

7 U.S.C. § 1 et seq.(1988) ..... 23

9 U.S.C. § 4 (1988)..... 17

9 U.S.C. § 10(a)(4) (1988) ..... 5

9 U.S.C. § 10(d) (1988)..... 19

15 U.S.C § 78c(a)(21) (1988)..... 21

15 U.S.C. § 78s(b)(1) (1988)..... 24

28 U.S.C. § 1254(1) (1988)..... 2

28 U.S.C. § 1332 (1988)..... 3

**Rules of Self-Regulatory Organizations**:

Chicago Board Options Exchange Rule 18.1(a), CBOE Guide (CCH) ¶ 2511 ..... 24

National Association of Securities Dealers, Inc. Rule 8(a), NASD Manual (CCH) ¶ 3708 ..... 24

New York Stock Exchange Rule 600(a), NYSE Guide (CCH) ¶ 2600 ..... 24

Pacific Stock Exchange Rule 12.1(a), PSE Guide (CCH) ¶ 6435 ..... 25

Philadelphia Stock Exchange Rule 950, § 6, PHLX Guide (CCH) ¶ 2950 ..... 23, 24



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Stephen H. Kupperman & George C. Freeman, III, Selected Topics in Securities Arbitration, 65 Tulane L.R. 1547, 1605 (1991) ..... 19-20

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MANUEL KAPLAN, CAROL KAPLAN and M.K. INVESTMENTS, INC.,

*Respondents.*

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

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Petitioner, First Options of Chicago, Inc. ("First Options")[1], seeks a writ of certiorari to review an opinion and order of the United States Court of Appeals for the Third Circuit which reversed, in part, an order granted by the district court in favor of First Options.[2] First Options'

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1 Pursuant to Rule 29.1, First Options is 100%-owned by SLK Acquisition Co., a Delaware corporation, which is 100%-owned by SLK Holdings, Inc., a Delaware corporation, which is 100%-owned by Spear, Leeds & Kellogg, a New York limited partnership. All of First Options' subsidiaries are wholly owned.

2 The petitioner, First Options, was a defendant/cross-petitioner and appellee below.

Petition for Rehearing With Suggestion For Rehearing *In Banc* was denied by the Third Circuit.

## OPINIONS BELOW

The order denying First Options' Petition for Rehearing With Suggestion For Rehearing *In Banc* was entered by the Third Circuit on June 29, 1994 and is reprinted at Appendix B[3]. The March 31, 1994 opinion of the Third Circuit is reported at 19 F.3d 1503 and is reprinted at App. A. The unpublished decision of the United States District Court for the Eastern District of Pennsylvania (Waldman, D.J.), is reprinted at App. C and may be found at 1992 U.S. Dist. LEXIS 14961 (E.D. Pa. Sept. 25, 1992).

## JURISDICTION

The United States Court of Appeals for the Third Circuit issued its opinion on March 31, 1994. App. A. The Court of Appeals denied a timely petition for rehearing with suggestion for rehearing *in banc* on June 29, 1994. App. B. This petition for a writ of certiorari is being docketed in this Court within 90 days from the denial of petition for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1988).

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3 References to opinions and orders reprinted in the Appendix appear throughout the petition as "App.", followed by the relevant appendix page designations.



## STATEMENT OF THE CASE

This case arises from the respondents' action seeking vacatur of an arbitration award and petitioner, First Options of Chicago, Inc.'s ("First Options") cross-action for confirmation of the award. The jurisdiction of the district court was invoked under 28 U.S.C. § 1332 because of diversity of citizenship, First Options being a citizen of Illinois and Delaware and the Respondents all being citizens of Pennsylvania.

First Options is a clearing member of the Philadelphia Stock Exchange ("PHLX" or the "Exchange") and other securities and commodities exchanges. Respondent MK Investments, Inc. ("MKI"), a member of and a market-maker on the Exchange, was a customer of First Options during the Stock Market Crash in October 1987, at which time MKI's trading account suffered substantial losses and incurred a deficit balance of $6,227,188. Respondent Manuel Kaplan ("Mr. Kaplan") is the president and sole shareholder of MKI, and Carol Kaplan ("Mrs. Kaplan") is his wife.[4] Following the Stock Market Crash, First Options and the Respondents executed a work-out agreement dated March 24, 1988 (the "Work-Out Agreement") that addressed the repayment of the loss in MKI's trading account.

First Options filed a Statement of Claim with the Philadelphia Stock Exchange in June 1989 seeking an arbitration award against the Respondents, alleging that

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4 Mr. Kaplan, Mr. Kaplan and MKI will be referred to collectively as "Respondents".

Respondents had breached the Work-Out Agreement. First Options asserted that MKI was liable for the account deficit, that Mr. Kaplan -- the alter ego of MKI -- was liable to the same extent as MKI, and that Mr. and Mrs. Kaplan were liable to First Options for certain tax refunds which were to have been paid over to First Options pursuant to the Work-Out Agreement.

MKI, Mr. Kaplan and Mrs. Kaplan answered First Options' Statement of Claim; Mr. Kaplan and MKI submitted separate counterclaims against First Options, each of which sought an award of $10 million; and, Mr. Kaplan and Mrs. Kaplan submitted objections to the jurisdiction of the Exchange. Subsequently, on February 26, 1990, the Kaplans' counsel withdrew their jurisdictional objections. In December 1991, the Kaplans reasserted their jurisdictional objections in a Motion to Dismiss submitted to the arbitrators. In an order dated January 14, 1992, the arbitrators denied the Kaplans' Motion to Dismiss on jurisdictional grounds. The matter proceeded to an arbitral hearing in May 1992 and, following eight days of hearings, a seven-member arbitration panel entered an award on June 5, 1992 in favor of First Options. This award required Mr. Kaplan and MKI, jointly and severally, to pay First Options $5,662,188 plus interest and required Mr. and Mrs. Kaplan, jointly and severally, to pay First Options $346,342 plus interest.

Respondents timely filed a petition to vacate the arbitrators' award in the United States District Court for the Eastern District of Pennsylvania, and First Options filed a cross-petition seeking confirmation of the award. Among other things, the Kaplans again challenged the arbitrators' jurisdiction over them, asserting that the arbitration panel



"exceeded its powers" in contravention of Section 10(d)(4) of the Federal Arbitration Act, 9 U.S.C. § 10(a)(4). Mr. Kaplan also challenged the arbitrators' determination that he was jointly and severally liable for the award against MKI.

The district court first considered whether the Kaplans had waived their jurisdictional objections, noting that "a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue." App. C at 14. The district court summarized the facts relevant to its analysis of whether the Kaplans had waived their jurisdictional objections as follows:

> At a pre-hearing conference on February 26, 1990, the Kaplans voluntarily withdrew jurisdictional objections previously filed, and participated in a discovery conference which was an integral part of the arbitration proceedings. Stip. at ¶ 6; Rec'd. at 130. There was no need or logical reason for the panel [of arbitrators] to address the Kaplans' initial objection to jurisdiction as that objection had been withdrawn. Only in January 1992, two and one-half years after the arbitration process had commenced and two years after withdrawing jurisdictional objections, did the Kaplans file a motion to dismiss for lack of jurisdiction. See Stip., ¶¶ 9, 11. The motion was denied on January 14, 1992. Stip., ¶ 12.

App. C at 15-16. Based upon these facts, the district court concluded that the Kaplans had "clearly indicated their

willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections." App. C at 15.

Having concluded that the Kaplans had waived their jurisdictional objections, the district court noted that the arbitrators' denial of the Kaplans' motion to dismiss the arbitration should be subject to a deferential standard of review. Nonetheless, the district court held that, even under a *de novo* standard, the arbitrators' decision could not be vacated, stating as follows:

> Where a party has waived jurisdictional objections, the court reviews [the arbitrators'] decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of the law. (Citation omitted.) . . . [T]he court concludes that even under a de novo review, the panel properly exercised jurisdiction. Accordingly, the arbitrators' decision to exercise jurisdiction would not be in manifest disregard of the law.

App. C at 18. On September 25, 1992, the district court denied the petition to vacate, granted First Options' petition to confirm the award and entered judgment on the award.

MKI, Mr. Kaplan and Mrs. Kaplan timely appealed the decision of the district court to the United States Court of Appeals for the Third Circuit. On March 31, 1994, the Court of Appeals filed its Opinion affirming the district court's judgment as to MKI, but reversing the district court's confirmation of the arbitration award against Mr. Kaplan and Mrs. Kaplan on jurisdictional grounds.



The Court of Appeals was presented with two questions concerning standards of review.

First, the Court of Appeals rejected First Options' suggestion that it reconsider its precedents and apply the United States Court of Appeals for the Eleventh Circuit's standard of appellate review for decisions denying a motion to vacate an arbitral award.

> We review a district court's denial of a motion to vacate a commercial arbitration award de novo. [Citing decisions of the United States Courts of Appeals for the Third, Fifth and Seventh Circuits.]
>
> First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. See Robbins v. Day, 954 F.2d 679, 681-82 (11th Cir.), cert. denied, ___ U.S. ___, 113 S. Ct. 201, 121 L.Ed.2d 143 (1992). We reject First Options' invitation.

App. A at 13-14.

The Court of Appeals also rejected First Options' assertion that the arbitrators' decision denying the Kaplans' motion to dismiss for lack of jurisdiction should be afforded the same deference as any other decision of the arbitrators. Instead, the Court of Appeals determined that "district courts should independently determine whether an arbitration panel has jurisdiction over the merits of any

particular dispute." App. A at 14 (quoting International Brotherhood of Teamsters, Local 249 v. Western Pennsylvania Motor Carriers Association, 574 F.2d 783, 787 (3d Cir.), cert. denied, 439 U.S. 828 (1978) ("A jurisdictional decision by an arbitrator that he has authority to decide a dispute is subject to a much broader and more rigorous judicial review")).

Applying the *de novo* standard of review to the arbitrators' decision on arbitrability, the Court of Appeals rejected four separate grounds[5] set forth by First Options in support of the arbitrators' jurisdiction and decided that the arbitrators lacked jurisdiction over the Kaplans. Among other things, the Court of Appeals decided that, despite Mr. Kaplans' status as an "associated person" of an Exchange member, he was not subject to the arbitral jurisdiction of the Exchange -- despite Exchange rules to the contrary. App. A at 40.

First Options filed a petition for rehearing with suggestion for rehearing *in banc* that was supported by the Philadelphia Stock Exchange, the Chicago Mercantile Exchange, the Chicago Board of Trade and the National Futures Association as *amici curiæ*. The petition for rehearing noted that the Court's decision to review de novo the arbitrators' decision as to arbitrability was in conflict with decisions of not only the Third Circuit, but also the

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5 First Options argued that Mr. Kaplan was subject to Exchange jurisdiction based upon (1) his status as an associated person of a member at all relevant times, (2) his status as a member when the deficit was incurred, (3) his status as the alter ego of a member at all relevant times, and (4) his execution of the Work-Out Agreement, which contained an arbitration clause in the Subordinated Loan Agreement.



First, Sixth, Eighth and Ninth Circuits. Additionally, the petition for rehearing noted the detrimental impact on dispute resolution in the securities and commodities contexts that would result from the decision limiting the arbitral jurisdiction of the Exchange over "associated persons" of its members. The Court of Appeals for the Third Circuit denied the petition for rehearing with suggestion for rehearing *in banc* on June 29, 1994. App. B.

## REASONS FOR GRANTING THE WRIT

### Summary Of Argument

The courts of appeals are divided over the appropriate standards of review to be applied under the Federal Arbitration Act (1) by a district court reviewing an arbitrator's decision as to arbitrability and (2) by a court of appeals reviewing a district court's decision granting a petition to confirm an arbitral award or denying a petition to vacate such an award. All courts, however, are in unison in recognizing a national policy favoring arbitration as a form of alternative dispute resolution. The division among the courts of appeals is disruptive of this policy and, more importantly, the standards of review applied by the Third Circuit fail to reflect this policy. Therefore, this Court should grant the writ and resolve the conflicts between the courts of appeals in favor of the more deferential standards of review that are consistent with the policies underlying the Federal Arbitration Act.

Additionally, in a matter of great public importance, this Court should grant certiorari in order to correct that portion of the Court of Appeals' decision which calls into question the arbitral jurisdiction of national securities and

commodities exchanges over disputes between their members and "associated persons" of their members. This decision, if allowed to stand, threatens the usefulness of arbitration in the securities and commodities industry insofar as it limits the jurisdiction of exchanges over the very persons frequently at the heart of otherwise arbitrable disputes; i.e., associated persons. Again, to further the national policy favoring arbitration -- specifically, in securities and commodities disputes -- this Court should grant the writ and clarify the extent of the Exchange's arbitral jurisdiction.

## I. There Is A Conflict Among The Circuits Regarding The Standard Of Review To Be Afforded To Arbitrators' Decisions On Arbitral Jurisdiction, Where The Parties Have Presented The Issue Of Arbitrability To The Arbitrators For Determination.

The Court of Appeals' decision to review *de novo* the issue of arbitrability after the arbitrators had considered and ruled upon the Kaplans' motion to dismiss for lack of jurisdiction is in conflict with the decisions of Courts of Appeals for the First,[6] Sixth,[7] Eighth[8] and Ninth[9] Circuits.

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6 Local 369 v. Boston Edison Co., 752 F.2d 1, 3 (1st Cir. 1984) (where the issue of arbitrability was submitted to the arbitrator, the court held that "[d]ecisions on questions expressly committed to the arbitrator for determination are reviewable only to the extent necessary to determine if the arbitral award 'draws its essence from the collective bargaining agreement'."). But see Mobil Oil Corp. v. Local 8-766, 600 F.2d 322, 324-25 (1st Cir. 1979) (where neither party "contest[ed] the principle that the court . . . has an obligation to make its own determination of the arbitrability of the dispute presented," the court held that "[w]hile a court may refer to an arbitrator's discussion on



The Sixth Circuit, for example, holds that "an arbitrator's decision on the issue of arbitrability was not subject to independent judicial review". Vic Wertz Distributing Co. v. Teamsters Local 1038, 898 F.2d 1136, 1139-40 (6th Cir. 1990). In addition to the Third Circuit,[10] the Fourth,[11]

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arbitrability in order to aid its determination, . . . it must make its own independent determination of the threshold issue").

7 Interstate Brands Corp. v. Chauffeurs, Teamsters, Warehousemen & Helpers Local Union No. 135, 909 F.2d 885 (6th Cir. 1990) ("In the present case, as in Vic Wertz, the parties submitted the issue of arbitrability to the arbitrator in the first instance. . . . Thus, the nature of our review of the arbitrator's ruling on arbitrability is different than the situation where the Company refused to arbitrate altogether and the Union brought an action in district court to compel arbitration"), cert. denied, 499 U.S. 905 (1991).

8 Franklin Electric Co. v. International Union, 886 F.2d 188 (8th Cir. 1989) ("Here, although the record is clear it objected to the arbitrator's jurisdiction to decide the arbitrability question, Franklin Electric proceeded to argue the issue to the arbitrator without expressly reserving the issue for initial judicial resolution. By their conduct the parties granted the arbitrator jurisdiction to decide their arbitrability question . . .. Once an issue is properly before the arbitrator, the standard of judicial review for the decision is deferential").

9 George Day Constr. Co. v. United Brotherhood of Carpenters, 722 F.2d 1471, 1476 (9th Cir. 1984) ("where the question of arbitrability is decided by the arbitrator, we are not at liberty to substitute our own view in place of the arbitrator's regardless what our view might be of the correctness of the arbitral decision").

10 But see United Industrial Workers v. Government of the Virgin Islands, V.I., 987 F.2d 162, 167 (3d Cir. 1993) ("If the parties submit the issue of arbitrability to the arbitrator, however, a court is obliged to give the arbitrator's decision regarding the arbitrability of a matter the same deference due an arbitrator's decision on the merits"); GK MGT Inc. v. Local 274, Hotel Employees and Restaurant Employees Union,

Seventh[12] and District of Columbia[13] Circuits have adopted holdings suggesting that an arbitrator's decision regarding arbitrability is not entitled to deference, at least where the party objecting to arbitration jurisdiction expressly reserves the issue for judicial review. Thus, the Circuits are in need of clear guidance from this Court on the appropriate standard of review to be applied to an arbitrator's decision as to arbitrability where the issue has been submitted to the arbitrator for decision.

This Court should grant certiorari in order to resolve the existing conflict between the Circuits in a manner that is consistent with this Court's decisions over the last decade

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AFL-CIO, 930 F.2d 301, 304 (3d Cir. 1991); Pennsylvania Power Co. v. Local Union No. 272, 886 F.2d 46 (3d Cir. 1989); Johnson v. United Food & Comm. Workers, 828 F.2d 961, 964-65 (3d Cir. 1987); and United Steelworkers of America v. American Smelting & Refining Co., 648 F.2d 863 (3d Cir. 1981), cert. denied, 454 U.S. 1031 (1981).

11 Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos, 25 F.3d 223, 226 (4th Cir. 1994) (stating, in dictum, that if the arbitrators had interpreted the parties' contract, "their interpretation would not be entitled to deference because it would have involved a determination of their own jurisdiction.").

12 International Association of Machinists v. General Electric Co., 865 F.2d 902, 904 (7th Cir. 1989) ("The arbitrator is not the judge of his own authority -- though to this, as to most, legal generalizations, there is an exception. . . .").

13 Davis v. Chevy Chase Financial Limited, 667 F.2d 160, 166-67 (D.C. Cir. 1981) (holding that, where a party to an arbitration has challenged the arbitrator's authority to decide certain issues, "a reviewing court is obligated to make its own determination of the issue. . . . [but the] court's decision may, of course, be informed by the arbitrator's resolution of the arbitrability question . . ").



that have rejected "the old judicial hostility to arbitration." Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 480 (1989). The deferential standard of review applied by the First, Sixth, Eighth and Ninth Circuits is more consistent with this Court's recent precedents favoring the resolution of disputes through binding arbitration.[14]

In AT&T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643 (1986), the Supreme Court recognized that "Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." (Emphasis added.) Id. at 649 (citing, inter alia, United Steelworkers of America v. Warrior & Gulf Nav. Co., 363 U.S. 574, 582-83 (1960)).[15] Moreover,

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14 See Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989); Volt Information Sciences, Inc. v. Board of Trustees, 489 U.S. 468 (1989); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985); Southland Corp. v. Keating, 465 U.S. 1 (1985); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983). The case principally relied upon by the Court of Appeals to support a *de novo* standard of review, International Brotherhood of Teamsters, was decided by the Third Circuit in 1978, before this series of decisions by the Supreme Court unequivocally recognized arbitration as a judicially favored form of dispute resolution.

15 In United Steelworkers of America v. Warrior & Gulf Nav. Co., the Supreme Court recognized that parties could agree to submit not only questions on the merits of a dispute, but also the question of arbitrability, to the arbitrator. Warrior & Gulf, 363 U.S. at 583 n.7.

the Supreme Court has made abundantly clear that a court must give deference to an arbitrator's decision on a question submitted to the arbitrator by the parties for decision. United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593, 597 (1960). Thus, the Supreme Court has implicitly acknowledged that when the parties submit the issue of arbitrability to the arbitrator, it is to be decided by the arbitrator, not the Court.

In determining whether a party has clearly and unmistakably submitted the question of arbitrability to the arbitrators, the Ninth Circuit has held that a party to an arbitration, by its conduct, may impliedly submit the question to the arbitrators. George Day Constr. Co., 722 F.2d at 1475. The court in George Day examined the factual basis for finding an implicit submission of the question of arbitrability to the arbitrators, stating as follows:

> In the instant action the employer, by conduct[,] evinced clearly its intent to allow the arbitrator to decide not only the merits of the dispute but also the question of arbitrability. The merits of the dispute along with the question of jurisdiction were fully addressed by the parties during the proceeding and, at its conclusion, the entire controversy was submitted to the arbitrator for decision. Nowhere in the record is there any indication that the employer reserved the question of arbitrability for initial judicial determination in a judicial forum. Under these circumstances, we conclude that the employer impliedly consented to the arbitrator's deciding both the



> question of arbitrability and the merits of the controversy. The employer, by its conduct, clearly demonstrated this purpose.
>
> Had the employer objected to the arbitrator's authority, refused to argue the arbitrability issue before him, and proceeded to the merits of the grievance, then, clearly the arbitrability question would have been preserved for independent judicial scrutiny. The same result could be achieved by making an objection as to jurisdiction and an express reservation of the question on the record. However, where, as here, the objection is raised, the arbitrability issue is argued along with the merits, and the case is submitted to the arbitrator for decision, it becomes readily apparent that the parties have consented to allow the arbitrator to decide the entire controversy, including the question of arbitrability. (Emphasis added.)

George Day Constr. Co., 722 F.2d at 1475.[16]

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16 See also Freight Drivers v. Kingsway Transports, Inc., 1992 WL 281379, at *1 (W.D.N.Y. Aug. 31,1992) ("if a party objects to arbitrability and then proceeds to present such issue to the arbitrator, agreement to proceed before the arbitrator is assumed and, upon review by the court, again the deferential standard of judicial review is employed"); New York Hotel & Motel Trades Council, AFL-CIO v. Hotel Nikko of New York, Inc., 1991 WL 168284, at *4-5 (S.D.N.Y. Aug. 22, 1991) (because the defendant had not refused to argue jurisdiction before the arbitrator and had not moved to stay the arbitration, but had "extensively briefed the jurisdiction question" before the arbitrator, the defendant had waived its right to a de novo review of the arbitrator's jurisdictional determination). Cf. International Association of Machinists v. Fansteel, Inc., 900 F.2d 1005

The Ninth Circuit's analysis in George Day provides a party that objects to arbitral jurisdiction with several logical alternatives to protect against being forced to arbitrate in the absence of an agreement to do so, while at the same time, protecting both the integrity of the arbitral process and the rights of the opposing party. This analysis requires a party objecting to arbitral jurisdiction to choose whether to (1) expressly reserve the issue of arbitrability for *de novo* consideration by the courts or (2) submit the issue of arbitrability to the arbitrators, in which case the courts will grant deference to the arbitrators' decision.

Requiring the objecting party to expressly reserve *de novo* review by a court precludes that party from going through the entire arbitral process risk-free in the hopes of obtaining a favorable award, only to object to the arbitrators' jurisdiction in the event the arbitrator renders an unfavorable award. Such a "heads-I-win, tails-you-lose" approach leads to the potential waste of time, effort and expense by everyone involved and is extremely unfair to the opposing party[17], the arbitrators and the courts, whose powers are being manipulated in such circumstances.

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(7th Cir. 1990) (recognizing that a de novo review of a party's jurisdictional objections to arbitrability was appropriate because, at the commencement of the arbitration, that party expressly and explicitly preserved its right to challenge arbitrability after the arbitration), cert. denied, 498 U.S. 851 (1990); Wilkes-Barre Publishing Co. v. Newspaper Guild of Wilkes-Barre, 647 F.2d 372, 382 (3d Cir. 1981) (stating that "[t]he preservation of jurisdictional objections before an arbitrator is permissible" where a party expressly reserved the right to challenge arbitrability in a post-arbitration enforcement proceeding), cert. denied, 454 U.S. 1143 (1982).

17 If a party refuses to submit to arbitration and thereby preserves its objection to arbitrability, the opposing party would have the opportunity to seek a judicial resolution of the issue of arbitration jurisdiction prior to expending the time, effort and expense of a full arbitral proceeding. 9 U.S.C. § 4 (allowing a party to seek a court order compelling arbitration if an opponent refuses to arbitrate).



Mr. and Mrs. Kaplan have manipulated the arbitrators and the courts in the precise manner that the above-cited decisions sought to preclude. The Kaplans submitted their jurisdictional objection to the arbitrators (only after having previously withdrawn those objections); they failed to explicitly preserve their objections for independent judicial review; after the denial of their jurisdictional objections, Mr. Kaplan pursued his $10,000,000 counterclaim to the conclusion of the arbitration process without further objection. Indeed, the Kaplans participated in additional pre-hearing proceedings over the ensuing four months and, thereafter, in an eight-day evidentiary hearing without ever seeking an independent judicial review of the issue of arbitral jurisdiction or even indicating that they intended to do so following the hearing. This hearing required the presence of the parties, their respective counsel, seven arbitrators, the Exchange's Director of Arbitration, and, over the course of the proceedings, nineteen witnesses. After participating fully in this process without expressing their intent -- much less reserving the right -- to seek independent judicial review of the arbitrators' denial of their motion to dismiss (or, for that matter, ever again mentioning their jurisdictional objections before the arbitrators), the Kaplans should not be allowed to reassert their previously rejected jurisdictional objections for *de novo* review by a court.

## II. The Circuits Are In Conflict As To Whether A Court of Appeals Should Apply An Abuse-Of-Discretion Standard Or A *De Novo* Standard When Reviewing A District Court's Order Denying A Petition To Vacate, Or Granting A Petition To Confirm, An Arbitration Award.

While acknowledging precedent to the contrary in the Third Circuit, First Options argued that the Third Circuit should apply the United States Court of Appeals for the Eleventh Circuit's standard[18] of appellate review for decisions denying a motion to vacate an arbitral award. The Court of Appeals recognized the split of authority in the Circuits, but refused to adopt the standard applied by the Eleventh Circuit, stating as follows:

> We review a district court's denial of a motion to vacate a commercial arbitration award de novo. Colonial Indem Ins. Co. v. Omaha Indem. Co., 943 F.2d 327 (3d Cir. 1991); Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co., 868 F.2d 52, 56 (3d Cir. 1989) ("In reviewing the district court's denial of appellants [sic] motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the

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18 Robbins v. Day, 954 F.2d 679 (11th Cir.), cert. denied sub nom. Robbins v. PaineWebber Inc., 113 S. Ct. 201 (1992). See also Schmidt v. Finberg, 942 F.2d 1571, 1573 (11th Cir. 1991); Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 n.2 (11th Cir. 1990); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1383 (11th Cir. 1988).



> arbitration award pursuant to 9 U.S.C. § 10(d)."); see also RM Perez & Assocs. v. Welch, 960 F.2d 534, 540 (5th Cir. 1992); Moseley, Hallgarten, Estabrook & Weeden v. Ellis, 849 F.2d 264, 267 (7th Cir. 1988).
>
> First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. See Robbins v. Day, 954 F.2d 679, 681-82 (11th Cir.), cert. denied, ___ U.S. ___, 113 S. Ct. 201, 121 L.Ed.2d 143 (1992). We reject First Options' invitation.

App. A at 14. The standard of review applied by the Third Circuit, however, fails to give the appropriate level of deference to the decisions of arbitrators.

The Eleventh Circuit's standard of review, on the other hand, appropriately reflects the deference to the arbitral process and the confirmation of arbitral awards embodied in the Federal Arbitration Act and recognized by this Court. This dual standard of review, which defers to decisions that confirm or refuse to vacate arbitral awards but reviews *de novo* decisions that vacate or refuse to confirm such awards, has been explained as follows:

> The standard [of appellate review] most likely to reflect the strong federal policy favoring arbitration is a hybrid standard -- one that requires an appellate court to review confirmation of an award for an abuse of

discretion and to review vacation of an award de novo. Such a standard would . . . require rigorous review of rulings vacating awards but only limited review of rulings confirming awards. It would also mirror the structure of section 15 of the [Federal] Arbitration Act. Section 15 permits interlocutory appeals of orders favoring litigation over arbitration but not vice-versa. More specifically, it permits interlocutory appeals of orders denying motions to compel arbitration and motions to stay litigation pending arbitration but forbids interlocutory appeals of orders granting motions to compel and motions to stay. (Footnotes omitted.)

Stephen H. Kupperman & George C. Freeman, III, Selected Topics in Securities Arbitration, 65 Tulane L.R. 1547, 1605 (1991) (cited in Robbins, 954 F.2d at 682 n.3).

In adopting this "hybrid" standard of review, the Eleventh Circuit clarified the context in which arbitration awards are reviewed and the policies underlying such review, stating as follows:

> By broadly reviewing the grant of a motion to vacate an arbitration award, while narrowly reviewing confirmation of an award, we emphasize the unique context of arbitration, which requires deferential judicial review to promote the primary advantages of arbitration -- speed and finality. *De novo* review of the granting of a motion to vacate enables us to assess whether the district court accorded



> sufficient deference in the first instance, an assessment that a more restrictive appellate review would frustrate. See *Forsythe International*, 915 F.2d at 1020. When a district court denies a motion to vacate an arbitration award, deference is presumed and, therefore, in that context, review under an abuse of discretion is adequate. (Footnote omitted.)

Robbins, 954 F.2d at 682. This Court should grant certiorari and adopt the Eleventh Circuit's standard of review so that the standard which "promote[s] the primary advantages of arbitration" (id.) is applied uniformly throughout the country.

## III. In A Matter Of Great Public Importance, The Third Circuit Erroneously Held That, Absent Some Additional Evidence Of Consent To Arbitrate, An "Associated Person" Of An Exchange Member Is Not Compelled To Arbitrate A Dispute With An Exchange Member, Despite An Exchange Rule To The Contrary.

The Court of Appeals determined that, despite the Exchange's rule that associated persons[19] of Exchange members must submit to arbitration of disputes, Mr. Kaplan was not subject to the Exchange's arbitral jurisdiction even

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[19] An "associated person" is "any partner, officer, director, or branch manager of such member [of an exchange] (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member." 15 U.S.C. § 78c(a)(21) (1988).

though he was in fact an associated person of an Exchange member. (App. A at 35-40.) This decision threatens the entire structure -- established by Congress and recognized by the judiciary -- of self-regulation by national securities exchanges and associations, which have been designated as self-regulatory organizations ("SROs"). Indeed, this decision is particularly disruptive to that scheme because most of the individuals who participate in the significant business activity of the SROs are not members of the SRO, but are associated persons of members. Recognizing this, the SRO rules provide for arbitral jurisdiction over not only members, but also over associated persons of such members. This Court must reconsider, and correct, the Court of Appeals' holding as to the Exchange's jurisdiction over Mr. Kaplan as an associated person.

## A. The Holding of The Court of Appeals

There is no question that, under both federal statutes and the Exchange rules, Mr. Kaplan was an associated person of MKI -- a member of the Exchange -- at all relevant times. Indeed, the Court of Appeals expressly recognized that Mr. Kaplan was an associated person of MKI, stating as follows:

> First Options is correct in asserting that Mr. Kaplan is an associated person within the meaning of the [Securities and Exchange Act of 1934] and the Exchange's rules, including its rules concerning arbitration. . . . Therefore, Mr. Kaplan is without doubt an "associated person" of MKI. Mr. Kaplan continued to be an associated person of MKI as one of its directors, its president, and its sole shareholder



> after the workout was signed. (Emphasis added.)

(App. A at 35-36.) Section 6 of Philadelphia Stock Exchange Rule 950 clearly requires associated persons, like Mr. Kaplan, to submit disputes with members of the Exchange, like First Options, to arbitration, stating that:

> Any dispute, claim or controversy . . . between and/or among members and/or associated persons . . . arising in connection with the business of such member(s), or in connection with the activities of such associated person(s), shall be arbitrated under these procedures at the instance of:
>
> * * *
>
> (2) a member against a person associated with a member or a person associated with a member against a member . . . (Emphasis added.)

PHLX Rule 950, § 6, Philadelphia Stock Exchange Guide (CCH) ¶ 2950.

The Securities Exchange Act of 1934 ("Securities Exchange Act"), 15 U.S.C. § 78a et seq. -- like the Commodity Exchange Act, 7 U.S.C. § 1 et seq. in connection with the regulation of the commodities industry -- sets forth a comprehensive system for the federal regulation of the securities industry. As part of this system, Congress delegated to the Securities Exchange Commission ("SEC") the responsibility for overseeing the arbitration process at SROs and granted the SEC "expansive power to

ensure the adequacy of the arbitration procedures employed by SROs." Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 233 (1987). See also Walck v. American Stock Exchange, Inc., 687 F.2d 778, 786 (3d Cir. 1982) ("Congress . . . enacted the statutory schema that in its view would best serve its various goals of promoting transactional efficiency, fair dealing and investor protection, and of limiting expensive and ineffective federal intervention"), cert. denied, 461 U.S. 942 (1983). Thus, rules promulgated by SROs, including the arbitration rules of the Exchange, must be approved by the SEC, pursuant to Section 19(b)(1) of the Securities Exchange Act, 15 U.S.C. § 78s(b)(1) (1988). McMahon, 482 U.S. at 233-34. The SEC has approved the Exchange's arbitration rules. Sec. Exch. Act Rel. No. 34-29352, 56 Fed. Reg. 29511 (June 27, 1991).[20]

Notwithstanding the straightforward requirements of the Exchange's SEC-approved arbitration rules, the Court of Appeals engrafted upon the stated provisions of Exchange Rule 950, § 6 an additional requirement of independent consent to arbitrate by the associated person, stating:

> Where, as here, the arbitration involves an obligation the officer has undertaken separately and independently of his acts as an agent of the member that employs him, we believe some evidence of an associated person's consent to arbitrate beyond his or her employment as an agent or executive of a member must appear.

(App. A at 39.)

Essentially, the Court of Appeals disregarded the plain meaning of the Exchange rules and held that Mr. Kaplan's status as an "associated person" of an Exchange member, by itself, was insufficient to subject him to Exchange jurisdiction. This holding fails to reflect the practical reality of Mr. Kaplan's status as the sole shareholder, the president and director of MKI; that is, Mr. Kaplan controlled and directed all of MKI's operation and MKI acted through Mr. Kaplan in its (and his) Exchange-related activities. Even assuming the Court of Appeals correctly limited the Exchange's jurisdiction over associated persons to situations in which the associated person was acting as an agent of the member, First Options' claim against Mr. Kaplan was that he was acting as the agent and alter ego of MKI. Thus, even under the Third Circuit's restrictive view of Exchange jurisdiction, the Exchange had jurisdiction over First Options' claim against Mr. Kaplan.

More importantly, however, the Court of Appeals' restrictive reading of the Exchange rules disregards the Supreme Court's mandate that, when construing ambiguous arbitration agreements (even assuming the Exchange rules can be construed to be ambiguous), courts are to resolve all doubts in favor of arbitrability. Mitsubishi Motors Corp., 473 U.S. at 626; Moses H. Cone Memorial Hosp., 460 U.S. at 24-25. Applying the Supreme Court's guidance in this regard, the Exchange's arbitration rules must be

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[20] The provisions of the Philadelphia Stock Exchange arbitration rules are consistent with rules of other SROs providing for jurisdiction over associated persons. See National Association of Securities Dealers, Inc. Rule 8(a), NASD Manual (CCH) ¶ 3708. See also New York Stock Exchange Rule 600(a), NYSE Guide (CCH) ¶ 2600; Chicago Board Options Exchange Rule 18.1(a), CBOE Guide (CCH) ¶ 2511; Pacific Stock Exchange Rule 12.1(a), PSE Guide (CCH) ¶ 6435.

construed to extend arbitral jurisdiction to associated persons of Exchange members.

### B. The Court of Appeals' Holding Misconstrues Applicable Case Law And The Purposes Underlying Exchange-Based Arbitrations Between Members And Associated Persons

The Court of Appeals noted that a number of cases discussing arbitration with associated persons included the additional fact, not present here, that the associated person had executed a Form U-4 ("Uniform Application for Securities and Commodities Industry Representative and/or Agent"), which includes an arbitration clause requiring arbitration of employer/employee disputes. However, not all these cases relied on the existence of a U-4 in deciding the associated person issue.[21] Moreover, First Options has not discovered a single case -- and the Court of Appeals cited no such case -- in which a court has similarly engrafted a requirement that an associated person of an exchange member must independently consent to abide by exchange arbitration rules. To the contrary, at least five courts have required associated persons to arbitrate pursuant to SRO rules without any requirement that such persons had previously executed a Form U-4 or otherwise independently consented to arbitration.[22]

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21 See, e.g., Fleck v. E.F. Hutton Group, Inc., 891 F.2d 1047, 1054 (2d Cir. 1989) (holding that an employee, as an associated person, was required to arbitrate his dispute with a non-member of the New York Stock Exchange under that exchange's rules).

22 Swink & Co. & Hereth, 784 F.2d 866 (8th Cir. 1986); Creative Securities Corp. v. Bear Stearns & Co., 671 F. Supp. 961 (S.D.N.Y. 1987); Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp., 650 F. Supp. 222 (N.D. Ga. 1986); Brennan v. Stanford, 600 N.E.2d 404 (Ill. App. 1st Dist. 1992); Geldermann, Inc. v. Stathis, 532 N.E.2d 366 (Ill. App. 1st Dist. 1988).



In reaching its conclusion, the Court of Appeals attempted to distinguish Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp., 650 F. Supp. 222 (N.D. Ga. 1986), on the grounds that "[t]here was no dispute about Goldberg's consent to arbitrate. It was shown by his signature on a U-4 Form." (App. A at 39, citing Goldberg, 650 F. Supp. at 226.) However, the Goldberg decision does not indicate that Mr. Goldberg, an associated person of a member of the National Association of Securities Dealers ("NASD"), signed any U-4 Form or that, even if he had signed a U-4 Form, the court relied in any way on such a form. Instead, the Goldberg court concluded that Goldberg was required to arbitrate on the basis of his status as an associated person of an NASD member and the provisions of the NASD Code of Arbitration Procedure, stating:

> The NASD is a self-regulatory organization within the meaning of the Section 28(b) of the Securities Exchange Act. Thus, its members can agree to settle their disputes by arbitration. There is no requirement that such an arbitration agreement be signed by the party to be charged to be enforceable. Numerous courts have recognized that securities exchange members are contractually bound by the regulations of their organizations, including any arbitration provisions. There is no dispute that Goldberg was "a person associated with a member" at the time this dispute arose. There is no indication he was unaware of the NASD arbitration requirements or that his consent to those

> requirements was obtained fraudulently. Accordingly, the court finds Goldberg and [Donaldson, Lufkin & Jenrette] are parties to a valid arbitration agreement. (Citations omitted.) (emphasis added.)

Goldberg, 650 F. Supp. at 226. Thus, rather than requiring a signed Form U-4, the Goldberg court expressly stated that "[t]here is no requirement that such an arbitration agreement be signed." Id. To the extent that the Goldberg court found that Mr. Goldberg consented to arbitrate, it did so based simply upon his status as an associated person of a NASD member. Id.

The Court of Appeals also attempted to distinguish Swink & Co., 784 F.2d 866 (8th Cir. 1986). (See App. A at 38-39 n.23.) In Swink, a broker/dealer and an associated person of a broker/dealer were required to arbitrate a dispute arising out of the issuance of municipal bonds under the Arbitration Code of the Municipal Securities Rulemaking Board. Id. at 868. The Swink court never discussed -- let alone required -- a signed form or some other indicator of consent independent of the associated person's status as an associated person in order to hold that person subject to the arbitration rules of the self regulatory organization.

The Court of Appeals construed the Swink court's omission of any reference to "independent consent" as somehow consistent with a requirement of "independent consent". First Options suggests that the Swink court did not discuss the need for "independent consent" because there is no such requirement. Simply by becoming an associated person of a member of a self-regulatory agency,



an associated person consents to be subject to the rules of that body, including its rules regarding arbitration. Swink, 784 F.2d 868; Goldberg, 650 F. Supp. at 226.[23]

When Mr. Kaplan became an associated person -- i.e., a director, the president, and the sole shareholder -- of a member of the Exchange, he thereby consented to be bound by the Exchange rules regarding associated persons, including the Exchange's rules regarding arbitration. Mr. Kaplan was intimately involved with every aspect of MKI's operation and activities on the Exchange; indeed, he personified MKI on the Exchange. As such, he was fully aware that the Exchange rules imposed certain obligations on associated persons of members of the Exchange, including the obligation to arbitrate disputes with other members. As both the arbitrators and the District Court found, Mr. Kaplan was subject to the arbitral jurisdiction of the Exchange and he was required to submit to the

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23 See also Fleck, 891 F.2d at 1054; Creative Securities Corp. v. Bear Stearns & Co., 671 F. Supp. 961, 966 & n.8 (S.D.N.Y. 1987) (holding that members and persons associated with members of the NASD were obligated to arbitrate pursuant to the NASD Code of Arbitration Procedure); Brennan v. Stanford, 600 N.E.2d 404, 406 (Ill. App. 1st Dist. 1992) ("It is undisputed that Stanford Securities, Inc. is a member of the NASD and that Brack Stanford is associated with that member entity. Plaintiff, too, was associated with the member. Accordingly, paragraph 3708 of the NASD Code, which specifically extends to disputes involving persons associated with members, is applicable to the circumstances presented here. . . . Based on the foregoing, . . . the NASD had jurisdiction to arbitrate the parties' dispute."), app. denied, 610 N.E.2d 1260 (Ill. 1993); Geldermann, Inc. v. Stathis, 532 N.E.2d 366, 368 (Ill. App. 1st Dist. 1988) (holding that members of the CBOE and associated persons of CBOE members have agreed as a matter of law to be bound by the rules of the CBOE, including the right to request arbitration).

arbitration of this dispute under the auspices of the Exchange.

The Court of Appeals' decision in this regard detracts from the ability of securities and commodities exchanges to fulfill their proper roles as self-regulatory organizations -- a role which can be filled only if the regulator has jurisdiction over all of the persons and entities to be regulated. In order to allow these SROs to fulfill the role envisioned for them by Congress, this Court should grant certiorari and clearly state the rules of these SROs which require associated persons to submit to arbitration of Exchange-related disputes are binding and enforceable.

## CONCLUSION

For all the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 27, 1994



**Filed March 31, 1994**

**UNITED STATES COURT OF APPEALS**
**FOR THE THIRD CIRCUIT**

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**NO. 92-1814**

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**MANUEL KAPLAN; CAROL KAPLAN;**
**MK INVESTMENTS, INC.,**

**Appellants**

**v.**

**FIRST OPTIONS OF CHICAGO, INC.,**

**Appellee**

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**Appeal from the United States District Court**
**for the Eastern District of Pennsylvania**
**(D.C. Civil Action 92-00210)**

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**Argued: June 23, 1993**

**PRESENT: STAPLETON, MANSMANN**
**and HUTCHINSON, *Circuit Judges***

**(Filed March 31, 1994)**

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**OPINION OF THE COURT**

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HUTCHINSON, *Circuit Judge*.

Appellants Manuel Kaplan, Carol Kaplan ("Kaplans"), and M.K. Investments, Inc. ("MKI"), appeal an order of the United States District Court for the Eastern District of Pennsylvania. It confirmed an arbitration award arbitrators appointed under the rules of the Philadelphia Stock Exchange ("the Exchange") had entered in favor of appellee First Options of Chicago, Inc. ("First Options").



The Kaplans argue that the arbitration panel lacked jurisdiction over them. First Options says that the Kaplans have waived any jurisdictional objections. Because they raised their objection to arbitral jurisdiction several times during the arbitration proceedings, we hold that the Kaplans have not waived it. We also reject First Options' alternate argument that an agreement MKI signed as part of a "workout," meant to settle a dispute arising out of Mr. Kaplan's activities as a principal of MKI and a former member of the Exchange, evidences the Kaplans' consent to arbitrate and the Kaplans' individual liability for performance of the workout. There was no arbitration clause in the workout document the Kaplans signed.

First Options' argument that Mr. Kaplan's position as an officer of MKI compelled him to arbitrate his obligations under the workout as an "associated person" of a member, MKI, is also rejected. The record does not contain any U-4 Form or other document evidencing Mr. Kaplan's agreement to arbitrate, and the terms of the workout plainly show that he did not agree to submit his personal responsibility for MKI's obligations to arbitration.

In addition, we reject First Options' argument that Mr. Kaplan's former membership in the Exchange subjected him to arbitration under its rules relating to members. The only dispute that arose while Mr. Kaplan was a member was the dispute that led to the workout, not the dispute over the workout's performance that the arbitrators heard.

Finally, we reject First Options' argument that Mr. Kaplan is the alter ego of MKI. The evidence of failure to observe corporate formalities in some distributions MKI made to him is insufficient to show that MKI was a sham that Mr. Kaplan manipulated in fraud of creditors.

We will therefore reverse the district court's order confirming the arbitration award against the Kaplans and remand the case to it with instructions to enter an order granting the Kaplans' request to vacate the arbitrators' award against them as individuals.[1] We will, however, affirm the district court's order confirming the arbitration ward as to MKI.[2]

## I. *Factual & Procedural History*

First Options is a "clearing firm" or "clearinghouse" and member of the Exchange. MKI, a Pennsylvania corporation, was an "options market maker"[3] on the Exchange from 1984 through 1989. First Options acted as MKI's clearing firm on the Exchange pursuant to a Market Maker's Agreement between MKI and First Options dated November 15, 1984. The Market Maker's Agreement,

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1 In a separate order, we will deny the Kaplans' motion to strike certain exhibits and appendices from First Options' brief as well as First Options' motion to file a supplemental appendix.

2 See *infra* note 30.

3 An "options market maker" trades options for its own account. A market marker's trading is facilitated by a "clearinghouse." It provides administrative support and risk control services and guarantees a market maker's account to other traders. A clearinghouse is compensated in part by commissions generated by the market maker.



executed by Mr. Kaplan on behalf of MKI, provided in part that "any controversy between [First Options and MKI] arising out of [MKI's] business or this agreement . . . shall be submitted to and determined by arbitration . . . ." Appendix ("App.") at 73. Mr. Kaplan has been the president, a director and the sole shareholder of MKI since 1986. MKI has been a member of the Exchange since 1984. From November 8, 1981, to December 8, 1987, Mr. Kaplan was also a member of the Exchange individually.

On October 19, 1987, corporate equities suffered an unprecedented drop in value. Stocks traded on the New York Stock Exchange, and those traded on regional exchanges, crashed. The Philadelphia Stock Exchange was no exception. Five days before the crash, MKI's trading account had a balance or net equity of approximately $10.5 million. On October 19, 1987, MKI lost over $12 million and its account had a deficit of $2.1 million by the end of the trading day.

As the clearing firm for MKI, First Options guaranteed to the Exchange and the persons with whom MKI traded that all positions in MKI's accounts would be covered. After trading closed on October 19, 1987, First Options was at risk on the $2.1 million deficit in MKI's account.

First Options' agreement with MKI gave it the right to liquidate MKI's positions "whenever in [First Options'] discretion [First Options] deem[ed] it necessary." App. at 72. Therefore, First Options took control of MKI's trading accounts and proceeded to liquidate any remaining positions which, in its opinion, posed significant

unacceptable risks. First Options' liquidation of MKI's positions increased MKI's deficit to $5.1 million.

MKI and First Options had, in the meantime, entered into settlement negotiations about MKI's continued operation. First Options pressed Mr. Kaplan to assume personal liability for MKI's obligations. Mr. Kaplan refused. Instead, he and MKI disputed the size of MKI's deficit and claimed that First Options' mishandling of the liquidation was only increasing the deficit. During these negotiations, Mr. Kaplan and his counsel told First Options that neither MKI nor Mr. Kaplan had any liquid assets to contribute to any settlement or workout beyond MKI's interest in a joint trading account, certain exchange memberships and the 1987 federal income tax refund the Kaplans were anticipating.[4]

Negotiations continued during November and December and there is evidence that the parties reached a "handshake" deal in December. On December 8, 1987, Mr. Kaplan relinquished his membership on the Exchange and negotiations continued. On March 24, 1988, the Kaplans, MKI, and First Options separately executed four documents evidencing an overall method of settling the dispute that had resulted from MKI's October 19, 1987, deficit. They were: (1) a Letter Agreement executed by First Options, MKI, Mr. Kaplan, Mrs. Kaplan, and certain other entities and individuals; (2) a Guaranty executed only by MKI;

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4 The expected refund may have been the result of MKI's problems. MKI was a Subchapter S corporation which passes its own income and losses through to its individual shareholders for inclusion in their individual tax returns.



(3) a Subordinated Loan Agreement executed by First Options, MKI, and a separate entity; and (4) a Subordinated Promissory Note executed by MKI. Only one of these four documents, the Subordinated Loan Agreement, contained an arbitration clause, and only First Options, MKI and the other entity, whose agreement to arbitrate is not material to this case, signed that document.[5] Individually, Mr. and Mrs. Kaplan signed only the Letter Agreement. It did not have an arbitration clause.

Under the terms of the Workout:

- MKI agreed to repay a total of $6,227,188, the full amount of its trading deficits, including the added $3 million incurred while First Options' was liquidating its risky accounts;

- MKI immediately transferred four Exchange memberships to First Options;

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5 The arbitration clause in the Subordinated Loan Agreement provided in relevant part:

> [A]ny controversy arising out of or relating to this [Subordinated Loan] Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

App. at 108-09.

- MKI and Mr. Kaplan immediately contributed $900,000 to a new Trading Account and MKI resumed trading on the new account in April 1988;

- Mr. Kaplan paid First Options $80,000;

- Mr. and Mrs. Kaplan agreed to remit to First Options their 1987 tax refund, estimated to be at least $300,000, upon its receipt;[6] and

- MKI agreed to split its trading profits with First Options.

First Options agreed to release MKI from any claims First Options might have against it for the disputed debt upon MKI's performance of all its obligations under the workout. First Options also agreed to release Mr. Kaplan, individually, from any claims First Options might have against him beyond those he had undertaken in the workout.

MKI resumed trading in April 1988. On January 16, 1989, before the parties had carried out all the terms of the March 1988 workout, MKI's account suffered another loss of over $1.5 million as a result of a takeover bid for one of

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6 This was Mrs. Kaplan's only obligation under the workout.



the companies in whose stock MKI had a position.[7] In response, First Options ordered Mr. Kaplan to reduce MKI's risk by adjusting some of the positions in MKI's account. Mr. Kaplan did not reduce the risk in MKI's account to First Options' satisfaction.

On January 17, 1989, First Options again took over MKI's accounts and began to liquidate all its positions. First Options also barred MKI and Mr. Kaplan from conducting business on the Exchange and ordered all MKI traders off the trading floor. This second liquidation took about four months. It added $65,000 to the deficit that had been outstanding when the workout began.

After taking control of MKI, First Options demanded an opportunity to inspect MKI's corporate books and the Kaplans' tax returns. It also demanded payment of the $300,000 tax refund the Kaplans had agreed to turn over and contended Mr. Kaplan, along with MKI, was liable for all sums still due from MKI because they were alter egos of each other. The Kaplans refused First Options' demands, asserting that it was again compounding the problem by its ongoing liquidation of MKI's accounts. First Options then declared all sums still due under the workout accelerated and demanded immediate payment of the accelerated debt.

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7 MKI was carrying large "short call" positions in securities of Texas Eastern Corp. These calls go down when the stock rises. On January 15, 1989, a takeover bid for control of Texas Eastern was announced. Its stock rose 50% above its January 14, 1989 closing price. The resulting decline in value of MKI's short calls caused the $1.5 million loss.

Ultimately, First Options submitted the dispute over the workout to the Exchange. It sought: (1) $6,292,421.60 from MKI for breach of contract; (2) $300,000, the amount of the Kaplans' 1987 tax refund, from the Kaplans individually; (3) $6,292,421.60 from Mr. Kaplan on the theory he was individually liable as MKI's controlling person; (4) $6,292,421.60 from Mr. Kaplan as MKI's alter-ego; plus (5) interest, costs, and attorneys' fees against MKI and the Kaplans.[8] MKI and First Options signed a submission agreement, separate and apart from the arbitration provision contained in the Subordinated Loan Agreement, submitting the case to the Exchange for arbitration. Mr. Kaplan and Mrs. Kaplan have never signed any such agreement.

On July 24, 1989, the Kaplans and MKI filed responses denying liability, and Mr. Kaplan and MKI filed counterclaims against First Options, each seeking $10,000,000 from First Options for breach of contract, interference with prospective business opportunities and libel and slander. The Kaplans also submitted written objections to the arbitrators' jurisdiction under the Exchange's arbitration rules. In them, the Kaplans stated, "The Philadelphia Stock Exchange . . . and the Arbitration

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8 Though it claimed a right to recover its damages from either Mr. Kaplan or MKI, First Options would, of course, be entitled to only one recovery of the $6,292,421.60 damages claimed. In addition, it is apparent from the submission that the only issue that affected Mrs. Kaplan was her liability for the $300,000 tax refund under the Letter Agreement. The submission of Mr. Kaplan's liability as a controlling person included possible liability under the Exchange rules relating to "members" and "associated persons."



Committee . . . lack jurisdiction over this matter and the purported claim should be dismissed." App. at 311-12.

On February 26, 1990, not quite two years later, there was a pre-hearing discovery conference. The Kaplans' former counsel participated in it without renewing the objections to the arbitrators' jurisdiction. The Kaplans contend his limited participation in the discovery conference did not waive their objections to jurisdiction. Neither the Kaplans nor First Options submitted any documents to the Exchange that confirmed the Kaplans' withdrawal of their objections to the arbitrators' jurisdiction at the discovery conference or thereafter, and the arbitration panel's February 26, 1990, discovery order did not mention jurisdiction.

For the next twenty-two months, no discovery took place and no motions were filed; nor did the arbitration panel conduct any proceedings or issue any rulings before January 10, 1992. In December 1991, the Kaplans retained new counsel. On January 6, 1992, they filed a motion to dismiss for lack of jurisdiction. They also complained about the arbitrators' failure to rule on the objections they had filed two years earlier and said they were "reiterat[ing] and renew[ing] their objections to the Committee's jurisdiction." App. at 194.

In response to the Kaplan's motion to dismiss for lack of jurisdiction, First Options argued in the alternative that Mr. Kaplan was bound to arbitrate under Exchange rules because he was a member of the Exchange at the time of the October 19, 1987 crash, because he is an associated person of a member, or because he was MKI's alter ego.

The Exchange denied the Kaplans' motion to dismiss for lack of jurisdiction without comment.

Sometime in May 1992, the matter finally proceeded to arbitration and, after eight days of hearings, the seven-member arbitration panel voted five to two to pierce the corporate veil and, on June 5, 1992, entered an award for $5,662,188.00 plus interest in favor of First Options and against Mr. Kaplan and MKI jointly and severally. The panel also ordered the Kaplans, jointly and severally, to remit their 1987 tax refund, $346,342.00, plus interest. Finally, it found for First Options on Mr. Kaplan's and MKI's counterclaims.

The Kaplans and MKI filed a petition to vacate the award in the district court and First Options filed a cross-petition for its confirmation. In an order accompanied by a memorandum opinion dated September 25, 1992, the district court confirmed the award. It held that Mr. and Mrs. Kaplan had consented to Exchange arbitration under the arbitration clause in the Subordinated Loan Agreement even though neither had ever signed that particular document. Alternately, the court held that the Kaplans' former counsel's participation in the 1990 discovery conference had waived their jurisdictional objections.

The district court then went on to affirm the arbitrators' decision to pierce the corporate veil on the merits. It also held, without explanation, Mr. Kaplans' release from individual liability was conditioned upon performance of the workout and that the release was ineffective because the workout had not been fully



performed,[9] but explained that the corporate veil would have been properly pierced even if the workout's provision released the Kaplans as individuals. The Kaplans and MKI filed a timely notice of appeal.[10]

## II. *Jurisdiction & Standard of Review*

The district court had subject matter jurisdiction over this action to confirm or vacate the arbitration award under 28 U.S.C.A. § 1332 (West 1993) and 9 U.S.C.A. §§ 9, 10 (West 1970 & Supp. 1993). We have appellate jurisdiction over MKI's and the Kaplans' appeal from the final judgment of the district court confirming the award under 28 U.S.C.A. § 1291 (West 1993).

We review a district court's denial of a motion to vacate a commercial arbitration award *de novo*. *Colonial Penn. Ins. Co. v. Omaha Indem. Co.*, 943 F.2d 327, 331 (3d Cir. 1991); *Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co.*, 868 F.2d 52, 56 (3d Cir. 1989) ("In reviewing the district court's denial of appellants [sic] motion to vacate the arbitration award, this Court will stand in the shoes of the district court and determine whether appellants were entitled to vacate the arbitration award pursuant to 9 U.S.C. § 10(d)."); *see also RM Perez & Assocs. v. Welch*, 960 F.2d 534, 540 (5th Cir. 1992);

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9 In deciding the issue of the arbitrators' jurisdiction, we do not reach the merits of whether the parties intended to release Mr. Kaplan unconditionally. See *infra* note 16.

10 Mr. Kaplan filed a petition in bankruptcy on February 2, 1993. Neither Mrs. Kaplan nor MKI are in bankruptcy. On March 11, 1993, the bankruptcy court entered an order modifying the automatic stay to permit this appeal to go forward as to Mr. Kaplan.

*Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988).

First Options asks us to reconsider these holdings and adopt instead the standard the United States Court of Appeals for the Eleventh Circuit uses. That court reviews decisions denying petitions to vacate arbitration awards for abuse of discretion. *See Robbins v. Day*, 954 F.2d 679, 681-82 (11th Cir.), *cert. denied*, 113 S. Ct. 201 (1992). We reject First Options' invitation. Even if this panel were to look favorably on the new standard it suggests, we could not adopt it. *See* Third Circuit Internal Operating Procedure 9.1 (1993) ("[N]o subsequent panel overrules the holding in a published opinion of a previous panel."). Only the Court *in banc* has power to change our present standard of review. *See* Third Circuit Internal Operating Procedures 9.1 (1993).

This Court has also held the district courts should independently decide whether and arbitration panel has jurisdiction over the merits of any particular dispute. In *International Brotherhood of Teamsters, Local 249 v. Western Pennsylvania Motor Carriers Association*, 574 F.2d 783 (3d Cir.), *cert. denied*, 439 U.S. 828 (1978), we stated:

> [W]hether the arbitrator has jurisdiction over a particular dispute -- i.e. whether the controversy is arbitrable -- is a question for the court to decide. A jurisdictional decision by an arbitrator that he has authority to decide a dispute is subject to a much broader and more rigorous judicial review. *Bieski v.*



> *Eastern Automotive Forwarding Co.*, [396 F.2d 32 (3d Cir. 1968)]. As we said in *Bieski*:
>
> > If, however, the private decision complained of is a "jurisdictional" one -- that a certain dispute will not be considered on its merits by the private decision-marker -- then the court is a proper forum to review this decision on the basis of its analysis of the contract entered into by the parties.

*Id.* at 787 (quoting *Bieski*, 396 F.2d at 38) (citations omitted).

We will exercise plenary review over the district court's determination that the arbitration panel had jurisdiction over the Kaplans insofar as it turns on questions of law. *See Mellon Bank v. Farino*, 960 F.2d 1217, 1221 (3d Cir. 1992). To the extent that the district court's determination of arbitral jurisdiction turns on findings of fact, however, our scope of review will be limited to whether those findings are clearly erroneous.

### III. *The Parties' Contentions*

The Kaplans argue that the Exchange's Arbitration Panel lacked jurisdiction over them because they never consented to jurisdiction either in the course of the arbitration proceedings or under the Letter Agreement, the only workout document they signed. First Options, on the

other hand, argues that the Kaplans waived any objection to the arbitrators' jurisdiction by voluntarily submitting the dispute to arbitration and withdrawing their objection to arbitral jurisdiction at the discovery conference. The Kaplans responded before the arbitration panel, the district court and now here that they had withdrawn the objection only for purposes of their participation in a discovery conference and participation in that limited way is not a waiver of their objection to the arbitrator's jurisdiction.

First Options also argues that this record establishes the Kaplans' consent to arbitration even if they did not waive their objection to jurisdiction. In support, it advances three alternate theories. Only the first applies to Mrs. Kaplan. They are: (1) the arbitration clause in the Subordinated Loan Agreement, one of the four documents embodying the workout, subjects the Kaplans to arbitration even though they did not sign it because the four documents refer to each other and must be read together as one agreement under general principles of contract law; (2) because Mr. Kaplan was a "member" of the Exchange at the time some of the underlying incidents occurred that led to the dispute which was the subject of the workout he consented to arbitral jurisdiction under the bylaws and rules of the Exchange requiring its "members" to arbitrate; and (3) Mr. Kaplan, as President of MKI, impliedly consented to arbitral jurisdiction under the bylaws and rules of the Exchange requiring an "associated person" of a member to arbitrate. Finally, First Options contends that Mr. Kaplan was an alter ego of MKI and therefore MKI's consent to arbitrate binds him. We will discuss each of these arguments in turn, beginning with waiver.



## IV. *Waiver of Objection to Arbitral Jurisdiction*

As one alternate basis for its conclusion that the arbitrators had jurisdiction over the Kaplans, the district court held their former counsel's participation in the 1990 discovery conference waived their objection to the arbitrators' jurisdiction.

A party does not have to try to enjoin or stay an arbitration proceeding in order to preserve its objection to jurisdiction. *See Pennsylvania Power Co. v. Local Union 272 of the Int'l Bhd. of Elec. Workers*, 886 F.2d 46, 50 (3d Cir. 1989); *Local 719, Am. Bakery and Confectionery Workers v. National Biscuit Co.*, 378 F.2d 918, 921-22 (3d Cir. 1967); *see also Avis Rent-A-Car Sys., Inc. v. Garage Employees Union, Local 272*, 791 F.2d 22, 26 (2d Cir. 1986) (citing *National Biscuit* for proposition that party does not have to seek stay of arbitration to preserve jurisdictional objection). Federal courts encourage participation in arbitration. Requiring parties to refuse to participate in order to challenge arbitral jurisdiction would not advance this goal.

A jurisdictional objection, once stated, remains preserved for judicial review absent a clear and unequivocal waiver. *See Pennsylvania Power Co.*, 886 F.2d at 50 (only where party has "clearly indicate[d] his willingness to forego judicial review" will court find waiver of jurisdictional objection) (quoting *National Biscuit*, 378 F.2d at 921-22). Therefore, where a party objects to arbitrability but nevertheless voluntarily participates in the arbitration proceedings, waiver of the challenge to arbitral jurisdiction will not be inferred. *Id.* In *Pennsylvania*

*Power Co.*, Penn Power had objected to the arbitrability of an issue in its answer to a grievance before the arbitrator, the district court and the court of appeals. *Id.* In *International Brotherhood of Teamsters*, in contrast, both the Union and the Association signed a submission form specifying the issues that could be submitted to arbitration. This Court nevertheless held "the fact that the Union disputed [the arbitrators'] jurisdiction and argued the merits before [the arbitrators] does not constitute a waiver of its jurisdictional objections." *International Bhd. of Teamsters*, 574 F.2d at 786 n.2 (citing *National Biscuit*, 378 F.2d at 921).

The Kaplans refused to sign any submission form. They asserted their objection to jurisdiction at the beginning of the arbitration proceedings. They reasserted it on the record before the arbitrators. Even if their former counsel withdrew the objections from consideration in order to participate in the discovery conference, neither that withdrawal or its scope is docketed or expressly noted in the arbitration record. Later, the Kaplans reasserted their objection in a motion to dismiss for lack of jurisdiction they filed in 1992, when the arbitration proceedings resumed. During the first two years between the 1990 discovery conference and the Kaplans' reasserting of their objection, the case was dormant, without discovery, hearing, motion or ruling.

In January 1992, the arbitration panel denied the Kaplans' motion to dismiss for lack of jurisdiction without stating why. When the Kaplans spoke with the Exchange's Director of Arbitration about the motion, she said only that



the denial was consistent with the Exchange Arbitration Panel's interpretation of jurisdiction. She did not mention waiver.

The district court initially thought the Kaplans' intentions concerning their objection to the arbitrators' jurisdiction were "at least somewhat ambiguous" when they chose to proceed with the 1990 discovery conference. App. at 627. It ultimately decided, however, that they had "clearly indicated their willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections."[11] Memorandum Opinion ("Mem. Op.") at 13 (citing *Yorkaire, Inc. v. Sheet Metal Workers Int'l Assoc. Local Union No. 19*, 758 F. Supp. 248, 253 (E.D. Pa. 1990), *aff'd mem.*, 931 F.2d 53 (3d Cir. 1991) (table)). In *Yorkaire*, the court held that an employer's objections to jurisdiction were waived once it had submitted to arbitration. *Yorkaire*, 758 F. Supp. at 255. There, the district court distinguished *Pennsylvania Power Co.* and *International Brotherhood of Teamsters* because the parties in those cases had persistently reiterated their objections. Mem. Op. at 11-14, n.7.

*Yorkaire* is materially different from this case, and the district court's reliance on it is misplaced.[12] In *Yorkaire*,

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[11] If this determination is treated as a finding of fact, it is clearly erroneous because the evidence does not support it if the proper standard of "clear and unequivocal waiver" is applied. If it is treated as the application of an incorrect legal standard, our review is plenary. Either way, it cannot stand.

[12] Our affirmance of the district court in *Yorkaire* without opinion is, of course, not precedential. *See Galgay v. Gil-Pre Corp.*, 864 F.2d

the employer belatedly argued that the substance of a union grievance was not a matter over which the arbitration panel had jurisdiction. Despite numerous earlier opportunities to do so, the employer did not contest the panel's jurisdiction to determine what disputes it could hear until after the panel decided the case adversely to it. *Yorkaire*, 758 F. Supp. at 253-54. In *Yorkaire*, the record also showed the employer had initially agreed to submit the question of jurisdiction to the arbitration panel itself. *Id.* at 253. The district court held that a challenge belatedly raised after an adverse ruling, coupled with an express submission of the issue of jurisdiction to the arbitration panel, compelled a finding of waiver. *Id.* at 255; *cf. Bergquist Co. v. Sunroc Corp.*, 777 F. Supp. 1236, 1251 (E.D. Pa. 1991) ("at some point it would [be] unfair . . . to allow [a party that was asserting an objection] to continue in the arbitration process, await an unfavorable decision, and then challenge the arbitration."). The Kaplans have not waited until an adverse decision to assert their objections. They have not clearly and unequivocally consented to arbitration.

This conclusion is supported by *International Brotherhood of Teamsters*. There, the parties had actually signed submission forms yet we held they had not waived their objections to the arbitrators' jurisdiction. *International Bhd. of Teamsters*, 574 F.2d at 786 n.2, 788. Here, the Kaplans reasserted their jurisdictional objection before commencement of the arbitration proceedings and

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1018, 1021 (3d Cir. 1988). Our election to distinguish it, rather than to consider the validity of its rationale, does not indicate we approve or disapprove it.



again, two years later, before the panel heard any evidence, as soon as activity in the case had resumed. The Kaplans did not waive their objections. They reasserted them regularly during the arbitration proceeding. Repeated objection was not required while the case lay dormant. Their participation in the 1990 discovery conference did not waive their objections to the arbitrators' jurisdiction. We cannot say that this act "clearly indicated [their] willingness to forego judicial review." *Pennsylvania Power Co.*, 886 F.2d at 50.

Likewise, Mr. Kaplan's filing of a counterclaim against First Options in the arbitration does not waive his objection to the arbitrators' jurisdiction. We believe filing a counterclaim does not waive an objection to jurisdiction. *Bayou Steel Corp. v. M/V Amstelvoorn*, 809 F.2d 1147, 1149 (5th Cir. 1987); *In re Arthur Treacher's Franchisee Litig.*, 92 F.R.D. 398, 413 (E.D. Pa. 1981); *cf. Neifeld v. Steinberg*, 438 F.2d 423, 431 n.17 (3d Cir. 1971) (dicta). We think Mr. Kaplan had a right, without waiving his objection to the arbitrators' jurisdiction, to file a counterclaim to protect himself against the possibility that the arbitrators could rule against him on the merits of First Options' claims. The counterclaim is not a clear or manifest expression of his "willingness to forego judicial review." *Pennsylvania Power Co.*, 886 F.2d at 50.

The district court erred in holding that the Kaplans had waived their jurisdictional objection. Therefore, we turn to First Options' other arguments in support of the Exchange Arbitration Panel's jurisdiction over the Kaplans.

## V. *Consent*

Arbitration is fundamentally a creature of contract. *See, e.g., United Steelworkers v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 582 (1960). The Supreme Court has stated: "arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *AT&T Techs., Inc. v. Communications Workers*, 475 U.S. 643, 648-49 (1986) (citations omitted). The Federal Arbitration Act makes written agreements to arbitrate "valid, irrevocable, and enforceable" on the same terms as other contracts. 9 U.S.C.A. §2 (West 1970). There must be evidence sufficient to establish the parties' consent to arbitration. "As a matter of contract, no party can be forced to arbitrate unless that party has entered into an agreement to do so." *PaineWebber Inc. v. Hartmann*, 921 F.2d 507, 511 (3d Cir. 1990). That agreement must be "express" and "unequivocal." *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54 (3d Cir. 1980). On the other hand, doubts about the intended scope of an agreement to arbitrate are resolved in favor of arbitration. *See, e.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

An arbitrator's decision on the merits will be affirmed as long as it "draws its essence" from the contract. *Pennsylvania Power Co.*, 886 F.2d at 48; *see also Par-Knit*, 636 F.2d at 54. An arbitrator's decision to assert jurisdiction over objection is, however, subject "to a much broader and more rigorous judicial review" than an arbitral decision on the merits. Because it is "a question for the



court to decide," it is subject to *de novo* judicial review. *International Bhd. of Teamsters*, 574 F.2d at 787.[13]

First Options makes three separate contentions in support of its argument that the Kaplans, or at least Mr. Kaplan, as a matter of contract consented to the jurisdiction of the arbitrators. They are:

> (1) the arbitration clause in the Subordinated Loan Agreement covers the Kaplans even though they did not sign it because it is an integral part of the four document package that makes up the workout the parties hoped would solve the problems arising out of MKI's October 19, 1987 deficit;

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13 *Pennsylvania Power Co.* is not to the contrary. Our statement there "[i]n considering the propriety of the arbitrator's decision on arbitrability, however, our review is subject to the same highly deferential standard we employ in reviewing arbitrators' rulings on the merits," *Pennsylvania Power Co.*, 886 F.2d at 48, must be read in light of the general understanding that jurisdiction is a question for the courts and our application of that principle in *International Brotherhood of Teamsters*. Moreover, in *Pennsylvania Power Co.* we recognized that a party with a jurisdictional objection should not be punished merely because that party proceeded with arbitration instead of seeking a stay and immediate judicial review. *Id.* at 50. *International Brotherhood of Teamsters* sets forth clearly and persuasively the reasons that led this Court to review independently timely jurisdictional objections despite the fact that the arbitrators had also considered them. If *Pennsylvania Power Co.* were read to create a different standard, it would be in conflict with our earlier holding in *International Brotherhood of Teamsters*. *Cf.* Third Circuit Internal Operating Procedure 9.1 (1993) ("[N]o subsequent panel overrules the holding in a published opinion of a previous panel.").

(2) Mr. Kaplan consented to arbitration under the Exchange rules because he continued to be an "associated person" of MKI, a continuing member of the Exchange throughout the abortive workout; and

(3) Mr. Kaplan consented to arbitration under the Exchange rules because he was a "member" of the Exchange when the October 19, 1987 dispute arose.

The district court considered only the first of the three, but in the end all three fail to come to grips with one significant set of material facts about which there is no genuine dispute. The record shows that from October 19, 1987 on, Mr. Kaplan persistently refused to take individual responsibility for MKI's obligations to First Options. There were negotiations from then until March 1988. During them, he offered to make some limited contributions to help eliminate the deficit MKI had incurred in the October 19, 1987 crash. That offer was accepted by First Options in March 1988 and its acceptance was formally embodied in the workout documents. These documents limited the Kaplans' obligations to the contribution of certain fixed sums and contained no promise to arbitrate. Thus, though we will separately consider all three of First Options' variations on the theme of consent, the common denominator which applies to all is the absence of any agreement to arbitrate in the only workout document the Kaplans signed as individuals.



### A. *The Arbitration Clause in the Subordinated Loan Agreement As Evidence of Consent*[14]

We begin with the argument in support of arbitration on a contract theory that the district court did consider. Did the arbitration clause in the Subordinated Loan Agreement MKI signed bind the Kaplans though they did not sign it? The district court said yes.

The workout had four documents. Only one, the Subordinated Loan Agreement, has an arbitration clause. MKI, not the Kaplans, signed the Subordinated Loan Agreement. First Options argues, however, that the arbitration clause in the Subordinated Loan Agreement nevertheless applies to the Kaplans. It says the four workout documents must be read together because they are all inextricably tied together as part of one transaction. It relies on the case of *Hagerman v. Schulte*, 181 N.E. 677 (Ill. 1932). In *Hagerman*, the court stated:

> Where two or more contracts are part of the same transaction and relate to the same subject-matter, are known to the parties, and are delivered at the same time to accomplish an agreed purpose, such contracts must be

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14 The Market-Maker Agreement with First Options which Mr. Kaplan had executed on behalf of MKI also has an arbitration clause providing "any controversy between [First Options and MKI] arising out of [MKI's] business or this agreement . . . shall be submitted to and determined by arbitration." App. at 73. Neither Mr. Kaplan nor Mrs. Kaplan were parties to the Market-Maker Agreement.

> construed together as parts of the same transaction; and this is so even though the contracts are not executed between the same parties.

*Id.* at 680. The four documents embodying the workout were all executed on March 24, 1988, for the same overall purpose. Therefore we agree with First Options that they should be construed together in accord with the unobjectionable general principle stated in *Hagerman*. On the other hand, we do not think *Hagerman* supports the proposition that an arbitration clause in a document signed by one party who has generally guaranteed performance of all the obligations other persons have individually undertaken binds those persons who have not signed the document that has the arbitration clause.

The circumstances of this case plainly negate the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. In the document they signed, they undertook only limited and precisely defined obligations. They eschewed any general responsibility for MKI's obligations. They did not sign any documents that stated they would arbitrate their individual liability under the workout. They have always contended they had no individual responsibility for any obligations MKI might have to First Options. Only MKI undertook overall responsibility. It did so in the Subordinated Loan Agreement signed only by it. The limited obligations the Kaplans did undertake in the workout document they signed indicates at least their belief that they are not individually and personally responsible for all the



obligations of the workout. Unless both parties are in accord, there is no meeting of the minds from which an agreement could be found.

We think people intend to perform the obligations that are embodied in the words of the formal agreements they sign: no more, no less. The workout, read as a whole, does not evidence that the Kaplans consent to arbitrate their individual liability for all the obligations MKI assumed in the Subordinated Loan Agreement it signed.

There is no ambiguity about the absence of any consent to arbitrate in the documents the Kaplans signed individually. The Letter Agreement does no more than obligate them to contribute their individual 1987 tax refunds to the workout. Their failure to do so by March 31, 1989, may be a breach of the Letter Agreement and so constitute an "Event of Acceleration" under the Subordinated Loan Agreement MKI signed, but it does not impose on the Kaplans any obligation to arbitrate or any of the other obligations MKI agreed to. Thus, *Hagerman* does not help First Options.

The other cases First Options and the district court rely on are also inapposite. In reaching its decision that "[t]he Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and the relationships of the parties[,]" Mem. Op. at 11, the district court relied upon *Com-Tech Associates v. Computer*

*Associates International, Inc.*, 753 F. Supp. 1078 (E.D.N.Y. 1990), *aff'd*, 938 F.2d 1574 (2d Cir. 1991).

*Com-Tech* is distinguishable on much the same basis as *Hagerman*. Com-Tech and Computer Associates had signed a partnership agreement containing an arbitration provision. Computer Associates sought to compel Com-Tech to arbitrate a dispute arising out of a marketing agreement Com-Tech and it had signed along with the partnership agreement. Though the marketing agreement did not have an arbitration clause, activities under the marketing agreement were one of the things the partnership was formed to engage in. Accordingly, the court held the arbitration clause in the partnership agreement Com-Tech had signed covered disputes about transactions under the marketing agreement that were undertaken on the partnership's behalf. *Id.* at 1084.[15]

In the recent case of *Eli Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110 (3d Cir. 1993), this Court held on agency principles that a party who did not sign the agreement out of which a dispute arose was nevertheless subject to arbitration under its arbitration clause. In *Pritzker*, the question was whether persons who acted wrongfully on behalf of their principal or without its

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15 On appeal, the United States Court of Appeals for the Second Circuit held Computer Associates had waived its right to avoid arbitration by participating in the arbitration process. Accordingly, it did not address arbitral jurisdiction. *Com-Tech*, 938 F.2d at 1575. Here, as we have demonstrated in Part IV., there is no waiver by the Kaplans.



authority could be compelled to arbitrate under an arbitration agreement the principal had signed. If First Options were still disputing Mr. Kaplan's responsibility for MKI's losses on October 19, 1987, *Pritzker* could be material. That is not the issue before us. Rather, it is the extent of Mr. Kaplan's obligations under the workout. Mr. and Mrs. Kaplan only contributed some of their individual assets to the workout without assuming any overall responsibility for MKI's obligations. Their responsibility is based on contract, not agency.

Our statement "[b]ecause a principal is bound under the terms of a valid arbitration clause, its agents, employees, and representatives are also covered under the terms of such agreements" does to apply here. *Pritzker*, F.3d at 1121 (citing *Arnold v. Arnold Corp. - Printed Communications for Business*, 920 F.2d 1269, 1281-82 (6th Cir. 1990); *Letizia v. Prudential Bache Secs.*, 802 F.2d 1185, 1187-88 (9th Cir. 1986)). *Arnold* and *Letizia* were also decided on agency principles. *See Arnold*, 920 F.2d at 1281-82; *Letizia*, 802 F.2d at 1187-88. There, individual brokers were entitled to invoke their brokerage firms' right to arbitration in an action against the firm and its agents for fraud and violation of the federal securities laws. Here, the Kaplans' obligation to arbitrate depends on contract, not on agency or their participation with MKI in a wrongful act or statutory tort.

Moreover, in *Pritzker*, the non-signatories and the signatory's interests were co-extensive. That community of interest was material to our decision there. *See Pritzker*, 7 F.3d at 1122. Likewise, in *Isidor Paiewonsky Assocs., Inc.*

*v. Sharp Properties, Inc.* 998 F.2d 145 (3d Cir. 1993), agents who had not themselves signed the arbitration agreement had interests largely co-extensive with those of their principals. *Sharp Properties*, 998 F.2d at 155. Here, only MKI assumed responsibility for all the obligations of the settlement. The Kaplans have always contended they were not individually liable for MKI's obligations and in the workout that contention was accepted. Thus, the Kaplans' breach could trigger MKI's obligations, but we do not think it could make their individual obligations coextensive with MKI's. The absence of an arbitration clause, or a cross-reference to it in the Subordinated Loan Agreement, in the document the Kaplans signed unambiguously shows their limited contractual obligation to provide funds to MKI was separate from and independent of MKI's obligations, including its express obligation to arbitrate.[16]

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16 The Kaplans argue that differences in language in the release in the workout document they signed individually and language in MKI's release lead to the conclusion that the documents embodying the workout must be construed as treating MKI's corporate obligations separately from the Kaplans' individual obligations. First Options argues the Kaplans' release is conditional on the success of the workout. Mr. Kaplan's release read as follows:

> You [First Options] and your subsidiaries do hereby forever release, discharge, waive and forgive all actions, causes, [sic] of action, suits, accounts, demands, costs, expenses and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, or which their respective successors or assigns, hereafter ever may have *against Mr. Kaplan* . . ., for, upon or by reason of any activities relating to the Total Indebtedness . . . *on or at any time prior to the date of the signing of this Agreement; provided, however, you and your subsidiaries do not release Mr. Kaplan or Larry Goldberg from complete performance of the terms of this agreement and other documents contained herein and applicable to them.*



App. at 86 (emphasis added). MKI's release reads as follows:

> Upon termination of this Agreement, the release of or payment in full of the Subordinated Notes and other valuable consideration, receipt and sufficiency of which is hereby acknowledged, you [First Options] and your subsidiaries do hereby forever release, discharge, waive and forgive all manner of actions, . . . damages, claims . . . and other liabilities of any kind whatsoever, in law or in equity, which you or your subsidiaries may now have, or which you or your subsidiaries ever had, . . . against MK . . . for, upon or by reason of any activities relating to the Total Indebtedness, including the payment thereof, in the following accounts. . . .

*Id.* at 85-86. Those differences may add some support to the Kaplans' argument that the arbitration clause in the workout document MKI signed does not bind them individually, but they are inconclusive. Accordingly, we do not rely on them.

Whether the release is conditional is not material on the arbitrators' jurisdiction over the Kaplans. The fact that is material on the arbitrators' jurisdiction is the absence of any arbitration clause in the agreements the Kaplans signed as opposed to its presence in the Subordinated Loan Agreement only MKI signed. On the merits the question whether the parties intended to release Mr. Kaplan from any liability on the losses MKI suffered October 19, 1987, in return for the contributions he and Mrs. Kaplan made to the workout or instead intended to preserve whatever rights First Options might have against him for his management of MKI if the workout failed could become material.

Arbitration was not among the obligations the Kaplans assumed as part of the workout. Indeed, First Options never argued before the arbitrators that the Kaplans could be compelled to arbitrate on an agency theory. If First Options' argument were accepted, every agent of a party who agrees to arbitration would have to arbitrate individual obligations assumed independently of the contract of agency.

The district court erred in holding the arbitration provision in the Subordinated Loan Agreement, a document the Kaplans did not sign, evidenced the Kaplans' consent to arbitrate their individual liability.[17] Thus, we go on to consider the effect the Exchange's bylaws may have on Mr. Kaplan, an issue the district court did not reach.

### B. *The Exchange's Bylaws As Evidence of Consent*

First Options contended before the arbitration panel and the district court that Mr. Kaplan was subject to the arbitrators' jurisdiction under the Exchange's bylaws and rules either as a "member" of the Exchange or as an "associated person" of a member. When the arbitration panel denied the Kaplans' motion to dismiss for lack of jurisdiction and went on to consider the dispute over

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17 Because this was the only potential basis other than waiver for the arbitrators' jurisdiction over Mrs. Kaplan, *see* Brief for Appellees at 23, First Options' remaining arguments do not affect her and therefore the district court's order confirming the arbitration award against her must be vacated.



performance of the workout on its merits, it did not give any rationale for its decision to assume jurisdiction.

After the district court held that the Kaplans had waived their jurisdictional objection and, alternately, that the arbitration panel had jurisdiction over the Kaplans by virtue of the arbitration clause in the Subordinated Loan Agreement, it had no occasion to address First Options' contention that Mr. Kaplan's individual membership in the Exchange before the workout was signed or his continuing service as an officer of MKI thereafter showed his consent to arbitration. First Options, however, continues to press its contentions that these facts evidence consent in this Court and we must consider them.

The Supreme Court has stated the Securities and Exchange Commission has "expansive power to ensure the adequacy of the arbitration procedures employed by [a self-regulating organization]." *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 233 (1987). The National Association of Securities Dealers ("NASD") and other regional exchanges, including the Philadelphia Stock Exchange, are self-regulatory organizations within the meaning of section 28(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78bb(b) (West 1981 & Supp. 1993). Its members and their employees can unquestionably agree to arbitrate all disputes arising out of their use of the Exchange's trading facilities. *Creative Sec. Corp. v. Bear Stearns & Co.*, 671 F. Supp. 961, 966 n.7 (S.D.N.Y. 1987), *aff'd*, 847 F.2d 834 (2d Cir. 1988); *Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 650 F. Supp. 222, 225-26 (N.D. Ga. 1986).

Nevertheless, "'federal policy alone cannot be enough to extend the application of an arbitration clause far beyond its intended scope.'" *Haviland v. Goldman, Sachs & Co.*, 947 F.2d 601, 605 (2d Cir. 1991) (quoting *McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co.*, 858 F.2d 825, 831 (2d Cir. 1988)), *cert. denied*, 112 S. Ct. 1995 (1992). In order to compel arbitration, we think there should be some evidence of agreement or consent to abide by the Exchange's rules before a member or associated person can be compelled to arbitrate. *See Tullis v. Kohlmeyer & Co.*, 551 F.2d 632, 635-37 (5th Cir. 1977); *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *Cullen v. Paine, Webber, Jackson & Curtis, Inc.*, 587 F. Supp. 1520, 1522 (N.D. Ga. 1984); *cf. Gateway Coal Co. v. United Mine Workers*, 414 U.S. 368, 374 (1974) ("No obligation to arbitrate . . . arises solely by operation of law. The law compels a party to submit his grievance to arbitration only if he has contracted to do so.").

With this general principle in mind, we consider First Options' contentions that Mr. Kaplan has agreed to Exchange arbitration because of his status as (1) an "associated person" of MKI or (2) a "member" of the Exchange.



### 1. *Associated Person*

The Philadelphia Exchange's bylaws and rules do not define "associated person."[18] The Securities and Exchange Act of 1934, the authority for an individual exchange's self-regulating rules, *see* 15 U.S.C.A. §§ 78f(b), 78o-3(b)(8), 78s(g)(1), does. It defines "person associated with a member" or "associated person of a member" as "any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member." 15 U.S.C.A. § 78c(a)(21) (West 1981).[19]

First Options is correct in asserting that Mr. Kaplan in an associated person within the meaning of the Act and the

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18 The NASD Bylaws, in contrast, specifically define "person associated with a member" as:

> every sole proprietor, partner, officer, director, or branch manager of any member, or any natural person occupying a similar status or performing similar functions, or any natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by such member, whether or not any such person is registered with [NASD] pursuant to these Bylaws[.]

*Tays v. Covenant Life Ins. Co.*, 964 F.2d 501, 502 (5th Cir. 1992) (quoting NASD By-Laws, Art. I(m)).

19 This argument is encompassed in First Options' and MKI's submission of the issue of Mr. Kaplan's liability as a "controlling person" to the arbitrators.

Exchange's rules, including its rules concerning arbitration. The Philadelphia Exchange bylaws and rules were adopted pursuant to the Securities and Exchange Act. Therefore, Mr. Kaplan is without doubt an "associated person" of MKI. Mr. Kaplan continued to be an associated person of MKI as one of its directors, its president, and its sole shareholder after the workout was signed.

First Options argues the Exchange's adoption of a rule including an arbitration provision is all that is needed to require an associated person to arbitrate. If First Options is right, no separate agreement or other evidence of Mr. Kaplan's consent to arbitrate is necessary.[20] His consent to the Exchange's rules on arbitration can be implied from his position as chief executive of MKI. *See Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 830 (D.C. Cir. 1987) (phrase "associated person" is "not defined in the NYSE rules, but its use therein is clearly meant to draw on the definition found in the Securities Exchange Act of

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20 Section 1 of Rule 950 of the Philadelphia Stock Exchange Rules, entitled "Matters Eligible for Submission," does not expressly refer to "associated persons." We think though that its reference to "others" includes "associated persons." Section 6, entitled "Required Submissions," does expressly include "associated persons." *Compare* PHLX Rule 950 § 1 (Aug. 1991) *with* PHLX Rule 950 § 6(a). Because Section 1, setting forth "Matters Eligible for Submission," does not expressly state disputes involving associated persons are eligible for submission, it has been argued in other cases that disputes with associated persons are not "eligible" for submission despite Section 6. The United States Court of Appeals for the Fifth Circuit noted the problem but did not need to decide the issue under a similar provision of the NASD Code that explicitly limited eligible disputes to those listed in Section 1. *See Tays*, 964 F.2d at 502-03.



1934, which defines it to mean 'any partner, officer, director or branch manager' of a member firm") (quoting 15 U.S.C.A. § 78c(a)(21)); *see also Haviland,* 947 F.2d at 608 (Walker, J., dissenting) (same).

We do not think Exchange Rule 950 § 6(a)(2) requires Mr. Kaplan to arbitrate the dispute with First Options over the workout absent other evidence that he has individually agreed to submit to arbitration this particular dispute over his continuing individual responsibility for MKI's obligations. The workout documents themselves not only fail to furnish that evidence, they negate his consent to arbitration.[21] Because of the nature of this particular dispute and the terms of the workout documents that govern it, we conclude Mr. Kaplan was not required to arbitrate this matter.

Most of the cases that have considered whether persons associated with members of an exchange must arbitrate a dispute involving the exchange or the use of its facilities have required evidence other than the rule itself to show the associated person's consent to arbitrate. The courts deciding these cases have relied on the associated person's execution of a Uniform Application for Securities and Commodities and Industry Representative and/or Agent ("U-4 Form") or a provision in an exchange membership application to show consent. In the standard U-4 Form, an employee expressly agrees to abide by all the exchange rules and submit disputes involving it or a

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21 *See* Part V.A. *supra*.

member to arbitration.[22] *See, e.g., Haviland,* 947 F.2d at 604 (relying on employee's U-4 Form in exchange member brokerage firm); *Pearce*, 828 F.2d at 830 (looking to U-4 Form of branch office manager in member brokerage firms): *Tullis,* 551 F.2d at 634 n.4 (looking to allied membership application of former partners in exchange member firm in liquidation); *Coenen,* 453 F.2d at 1211-12 (relying on statement in application of officer of NYSE exchange member to be admitted to "allied" membership under NYSE rules); *Cullen*, 587 F. Supp. at 1523 (relying on U-4 Form of general securities representative employee in exchange member firm); *see also Banque de Gestion Privee SIB v. TransOptions, Co.,* No. 92 C 5252, 1993 WL 96453 (N.D. Ill. March 29, 1993) (arbitration not compelled in absence of arbitration clause in partnership agreement, filing of U-4 Form by partners or exchange member's express identification of partners as associated persons in filings with exchange).[23]

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22 The standard U-4 Form provides in part:

> [A]ny controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedures prescribed in the Constitution and Rules then obtaining of the New York Stock Exchange, Inc.

*Pearce,* 828 F.2d at 828 (emphasis omitted). It appears customary to have a prospective employee sign and submit a standard U-4 Form to the Exchange in order to obtain such employment. *See id.*

23 We do note that some cases require an associated person to arbitrate without discussing the need for a U-4 Form or other



Where, as here, the arbitration involves an obligation the officer has undertaken separately and independently of his acts as an agent of the member that employs him, we believe some evidence of an associated person's consent to arbitrate beyond his or her employment as an agent or executive of a member must appear.

First Options' reliance on *Goldberg v. Donaldson, Lufkin & Jenrette Sec. Corp.,* 650 F. Supp. 222 (N.D. Ga. 1986), in support of its argument that Mr. Kaplan is subject to arbitration because he is an associated person of MKI, is misplaced. There was no dispute about Goldberg's consent to arbitrate. It was shown by his signature on a U-4 Form.[24] *Id.* at 226.

The record before us does not have any independent evidence of Mr. Kaplan's agreement to arbitrate the question of his responsibility for MKI's obligations. No U-4 Form nor any other document signed by Mr. Kaplan

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independent evidence of consent. *See, e.g., Swink & Co. v. Hereth,* 784 F.2d 866, 868 (8th Cir. 1986) (requiring arbitration under municipal securities code rules between broker/dealer and its officer because officer was associated person without mention of U-4 Form or other independent evidence of officer's consent to arbitrate). None of them state, however, that additional evidence of consent is not needed. The point is simply not discussed.

24 Goldberg was a plaintiff who objected to arbitration. He did so primarily because he was no longer either a NASD member or an associate of a member once his firm had become defunct. He argued that his dispute did not arise as a broker or dealer but out of his activities as an individual investor who had not agreed to arbitration. *Goldberg,* 650 F. Supp. at 226.

shows he had agreed to arbitrate this particular dispute once he relinquished his own membership on the Exchange in December 1987.

Mr. Kaplan's status as an associated person of MKI did not evidence his individual agreement to assume the broad obligation to arbitrate that MKI expressly undertook when it signed the Subordinated Loan Agreement. Under the circumstances of this case, we reject First Options' argument that we can imply Mr. Kaplan's consent to arbitrate his individual liability for MKI's obligations under the workout from his association with MKI, the only party to the dispute who was still a member when the workout documents were signed.

**2. *Member***

First Options argues alternately that Mr. Kaplan's individual membership in the Exchange at the time of the crash that precipitated MKI's problem provides the necessary consent to arbitrate. There was a provision in Mr. Kaplan's membership agreement consenting to the Exchange rules, including its rules on arbitration; but Mr. Kaplan's Exchange membership ended in December 1987, several months before execution of the workout documents. See *Tullis*, 551 F.2d at 636-37; *Coenen*, 453 F.2d at 1211 (membership application requiring signatory to abide by exchange rules shows consent to arbitrate).

First Options says the December 1987 termination of Mr. Kaplan's Exchange membership does not matter. It



argues he is still subject to arbitral jurisdiction under Exchange Rule 950 because the circumstance that caused this dispute, the October 1987 stock market crash, happened when he was a member. First Options relies on a commentary to the applicable version of Rule 950, which was in effect until June 20, 1991. It stated: "For purposes of this Rule, the terms member, member organization and associated person of a member, shall be deemed to encompass those persons who were Exchange members at the time the circumstances occurred which gave rise to the controversy." PHLX Rule 950, Commentary .01. This commentary is consistent with case law holding that the membership which is material is membership at the time the events giving rise to the controversy occur. *Cf. Muh v. Newberger, Loeb & Co.*, 540 F.2d 970, 973 (9th Cir. 1976).

It is a dispute over Mr. Kaplan's performance under the workout that is now before us, or perhaps more specifically a dispute over whether the only obligations which survive the workout are those each of the parties undertook in the separate documents they signed to formalize the workout, rather than the earlier dispute over the deficit in MKI's account which arose as a result of the October 19, 1987 stock market crash. We think the workout documents independently define and limit the obligations Mr. Kaplan and MKI independently assumed. Under them MKI retained all the obligations it had as a result of the October 19, 1987 events. Therefore, the workout document the Kaplans signed negates any intent

on their part to arbitrate their individual responsibility for MKI's obligations.[25]

First Options did not seek arbitration of the original dispute while Mr. Kaplan was still a member of the Exchange. Instead, it agreed to the terms in the workout documents. They did not contain any agreement by Mr. Kaplan to arbitrate the question of his individual liability for MKI's obligations.

Here again, First Options' reliance on *Goldberg*, 650 F. Supp. at 225-26, is misplaced. That case concerned Goldberg's obligation to arbitrate a dispute about events that occurred while he was still a member or an associated person of an exchange member. *Id.* at 226 (citing *O'Neel v. National Assoc. of Sec. Dealers, Inc.*, 667 F.2d 804, 807 (9th Cir. 1982); *Isaacson v. Hayden, Stone Inc.*, 319 F. Supp. 929 (S.D.N.Y. 1970)). The *Goldberg* court did not have to consider the effect of an intervening agreement that defined Goldberg's individual obligations without providing for arbitration. The dispute about Goldberg's activities while he was an active member of the Exchange was uninterrupted. Mr. Kaplan terminated his membership before the workout documents were executed. They contained no agreement to arbitrate. The dispute before us

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[25] We note again that this conclusion does not depend on whether the releases in the workout were conditional upon performance of the parties' individual obligations under the workout. We assume they were, but it does not follow from that condition that any pre-existing obligations were reinstated.



concerns an alleged breach of the workout, not the events that led to it.

First Options cannot turn the clock back to the date of the stock market crash in order to require Mr. Kaplan to submit to arbitration because he was then bound by its rules as an exchange member. Accordingly, we reject First Options' contention that Mr. Kaplan's membership in the Exchange before execution of the workout subjects him to arbitration for breach of the workout document he signed after his membership terminated.

## VI. *Mr. Kaplan as an Alter Ego of MKI*

Finally, we consider First Options' argument that Mr. Kaplan was subject to binding arbitration as MKI's alter ego. The arbitrators accepted this contention after it was conceded that they had jurisdiction over MKI. They then resolved the alter ego issue against Mr. Kaplan on its merits. If they did so correctly, they would have jurisdiction to subject Mr. Kaplan to all the obligations MKI assumed in the Subordinated Loan Agreement, including its obligation to arbitrate. *See Interocean Shipping Co. v. National Shipping & Trading Corp.*, 523 F.2d 527, 539 (2d Cir. 1975) ("In an appropriate situation, the corporate veil may be pierced and a party may be held bound to arbitrate as the signatory's alter ego.") (citing *Fisser v. International Bank*, 282 F.2d 231, 233-34 (2d Cir. 1960)), *cert. denied*, 423 U.S. 1054 (1976); *see also Dighello v. Busconi*, 673 F. Supp. 85, 89 (D. Conn. 1987), *aff'd mem.*, 849 F.2d 1467 (2d Cir. 1988). But neither this Court nor the district court is bound by the arbitrators'

determination that Mr. Kaplan was the alter ego of MKI. He is entitled to an independent judicial determination of that issue. *Laborers' Int'l Union v. Foster Wheeler Corp.*, 868 F.2d 573, 575-77 (3d Cir. 1989) (per curiam) (right to independent judicial determination of arbitrator's jurisdiction based on alter ego status); *Sheet Metal Workers Intern. Assoc., Local No. 359 v. Arizona Mechanical & Stainless, Inc.*, 863 F.2d 647, 653 (9th Cir. 1988); *see also International Bhd.*, 574 F.2d at 787.

The district court concluded "[e]ven if [First Options had unconditionally released Mr. Kaplan from any liability for the debt in the Workout Agreement], it would not release MKI from liability for the debt and, on the record adduced, would not preclude a piercing of the corporate veil." Mem. Op. at 27. The district court felt "[i]t cannot be said the arbitration panel's decision to pierce the corporate veil was a decision made in manifest disregard of the law." *Id.* We think the district court erred when it used manifest disregard of the law as the standard for judging the arbitrators' alter ego conclusion.[26] Instead, it should

[26] The district court did not confirm the arbitral award against the Kaplans without giving the parties an opportunity to present additional evidence. The parties agreed arbitral record was sufficient to permit the district court to make any required findings of fact. When the district court affirmed the arbitrators' conclusion that Mr. Kaplan and MKI were alter egos, it did not consider the alter ego theory from the standpoint of arbitral jurisdiction. Having already held that the jurisdiction issue was waived, or alternately that the arbitration provision in the Subordinated Loan Agreement required the Kaplans to arbitrate, it confirmed the arbitrators' alter ego decision on its merits. If it had correctly reached the merits, it would have correctly used manifest disregard as the standard of review. *See Carte Blanche*



have determined the issue *de novo*. Manifest disregard applies when a court reviews the merits of an arbitrators' decision. It does not apply to judicial review of an arbitration panel's conclusion that one person is the alter ego of another for jurisdictional purposes. On those issues, courts review the record independently of the arbitrators. Therefore, we must consider the sufficiency of the evidence to show that MKI and Mr. Kaplan were alter egos under a standard less deferential than manifest disregard.

We begin with the proposition that generally a shareholder is not personally liable to perform corporate obligations. The corporate veil is pierced only when "the corporation was an artifice and a sham to execute illegitimate purposes and [an] abuser of the corporate fiction and immunity that it carries." *Wheeling-Pittsburgh Steel Corp. v. Intersteel, Inc.*, 758 F. Supp. 1054, 1058 (W.D. Pa. 1990) (citing *Zubik v. Zubik*, 384 F.2d 267 (3d Cir. 1967), *cert. denied*, 390 U.S. 988 (1968)). "In deciding whether to pierce the corporate veil, courts are basically concerned with determining if equity requires that the shareholders' traditional insulation from personal

*(Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd.*, 888 F.2d 260, 265 (2d Cir. 1989). On the issue of the arbitrators' jurisdiction over Mr. Kaplan, however, it should have considered the record independently. So considered, we conclude that the evidence is insufficient to permit a finding that Mr. Kaplan and MKI were alter egos. Any conclusion to that effect by the district court, even if treated as a finding of fact, would be clearly erroneous if the evidence that Mr. Kaplan ignored corporate formalities and manipulated MKI's affairs to defraud its creditors is legally insufficient to support the alter ego conclusion under our case law on the subject.

liability be disregarded and with ascertaining if the corporate form is a sham, constituting the facade for the operations of the dominant shareholder." *Id.* at 1057 (citing *Carpenter's Health & Welfare Fund v. Kenneth R. Ambrose, Inc.*, 727 F.2d 279 (3d Cir. 1983)).

The alter ego concept is a "tool of equity [that] is appropriately utilized 'when the court must prevent fraud, illegality or injustice, or when recognition of the corporate entity would defeat public policy or shield someone from public liability for a crime.'" *Carpenter's Health & Welfare Fund*, 727 F.2d at 284 (quoting *Publicker Indus., Inc. v. Roman Ceramics Corp.*, 603 F.2d 1065, 1069 (3d Cir. 1979)) (internal quotation omitted). Events that permit the corporate veil to be pierced include:

> "failure to observe corporate formalities, non-payment of dividends, insolvency of the debtor corporation at the time, siphoning of funds of the corporation by the dominant shareholder, non-functioning of other officers or directors, absence of corporate records, and the fact that the corporation is merely a facade for the operations of the dominant stockholder or stockholders."

*United States v. Pisani*, 646 F.2d 83, 88 (3d Cir. 1981) (quoting *DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 686-87 (4th Cir. 1976)). In addition, courts sometimes consider undercapitalization. *Id.*



Not every disregard of corporate formalities or failure to maintain corporate records justifies piercing the corporate veil. That remedy is available only if it is also shown that a corporation's affairs and personnel were manipulated to such an extent that it became nothing more than a sham used to disguise the alter ego's use of its assets for his own benefit in fraud of its creditors. In short, the evidence must show that the corporation's owners abused the legal separation of a corporation from its owners and used the corporation for illegitimate purposes. *See Zubik*, 384 F.2d at 267.

The testimony the arbitrators heard about Mr. Kaplan's personal use of MKI's corporate funds dealt largely with acts that took place in 1986 and 1987, before execution of the workout.[27] It consisted of:

- a withdrawal of $350,000 from MKI's trading account and a deposit of $361,000 into Mr. Kaplan's own account on the same day

- a check drawn on MKI's trading account that was traceable to Mr. Kaplan's purchase of a house

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27 Kevin McCarthy, an investigating accountant and CPA, provided most of the testimony concerning those transactions. He testified that he reviewed MKI's and Mr. Kaplan's financial information from February 1986 to January 1989, when MKI lost its trading ability, because those were the only years for which such information was readily accessible. Thereafter, there was little activity in MKI's accounts.

- a check for $1.4 million Mr. Kaplan wrote on his own checking account to cover a margin call on MKI for about that amount

- a transfer of $125,000 from MKI's trading account to Mr. Kaplan's personal account on which he then wrote checks totaling $125,000 to pay individual federal and state income taxes

- checks for $611,000 drawn to Mr. Kaplan on MKI's corporate account during the eight weeks that followed the October 19, 1987 crash when MKI appeared to be insolvent

- withdrawals aggregating $4.5 million from MKI's corporate account between February 1986 and January 1989 for Mr. Kaplan's personal use.

See Mem. Op. at 25-26.

Mr. Kaplan argues that withdrawal of some corporate funds for personal use before the workout documents were executed cannot make him liable for MKI's obligations as its alter ego because the workout could not be breached before it was signed. Though we think that argument lends some support to Mr. Kaplan's arguments against liability on an alter ego theory, it is not the whole answer to First Options' alter ego argument.

Neither are *Chicago Florsheim Shoe Store Co. v. Cluett, Peabody & Co.*, 826 F.2d 725, 727-28 (7th Cir.



1987), and *Connors v. Peles*, 724 F. Supp. 1538, 1559-61 (W.D. Pa. 1989), the cases on which First Options primarily relies to support the alter ego theory. They stand only for the general proposition that alter ego status is determined by conduct of the parties that is material to the dispute at hand. They are not controlling on whether Mr. Kaplan's failure to observe some corporate formalities before the present dispute over performance of the workout arose is material to its resolution.

On this record, however, we think Mr. Kaplan's disregard of corporate formalities in distributions he made to himself before execution of the workout may have some relevance to his responsibility for the obligations MKI assumed in the workout including its obligation to arbitrate.

First Options also pointed to some evidence of withdrawals after the workout documents were signed. Thus, it says Mr. Kaplan used a deceptive financing scheme to raise the $500,000 MKI agreed to and did contribute to the workout and that he falsely represented the source of that money. It points to other evidence that it says showed commingling after MKI resumed trading under the terms of the workout. First Options' witness, Mr. Murphy, testified that $100,000 was drawn out of MKI's trading account on December 21, 1988 and deposited into one of Mr. Kaplan's checking accounts that same day. Mr. Murphy went on to say Mr. Kaplan then transferred $100,000 from this checking account into another personal account on December 30, 1988. Then, on January 2, 1989, five checks were drawn on the latter personal account. They totaled

just under $100,000 and were payable to a real estate joint venture in which Mr. Kaplan was interested.

All this must be balanced against the lack of any evidence from which we might infer Mr. Kaplan's general non-compliance with corporate formalities. Testimony before the arbitrators indicated MKI was validly incorporated, it elected officers and directors, it held regular board meetings and prepared minutes, enacted by-laws, issued share certificates, entered into contracts in its own name, filed tax returns in its own name, maintained corporate books and records and had its own corporate checking account.

We have said MKI's argument that pre-workout events are immaterial to this dispute may lose some force on the alter ego theory. We think this is so because of the element of fraud that lies at its core. Fraud is often a basis for setting aside or refusing to enforce an agreement. Thus, if Mr. Kaplan's corporation, MKI, were a sham that he fraudulently manipulated to First Options' detriment, it would deprive him of the limitation of his own obligations that he sought to accomplish through the workout. But if First Options is to rely on a fraud theory, it must swallow the bitter with the sweet. Because alter ego is akin to and has elements of fraud, we think it too must be shown by clear and convincing evidence. That kind of evidence is not present here. *See Carpenter's Health & Welfare Fund*, 727 F.2d at 283. The record does not show Mr. Kaplan had a practice of culling profits from a failing company while creditors' attempts to seek payment were being rebuffed. Before the 1987 crash, MKI was a profitable entity from



which Mr. Kaplan, as sole shareholder, had a right to draw profits. Moreover, this record does not show that corporate formalities were generally ignored. Alter ego status cannot be inferred whenever a shareholder withdraws some monies from a corporation without formally declaring a dividend or executing a note even if one of the withdrawals is made while the corporation is insolvent.[28] If it did, every payment to a stockholder during insolvency would justify piercing the corporate veil.

The most serious act that occurred before the workout is Mr. Kaplan's withdrawal of $611,000 from MKI during the eight weeks following the October 19, 1987 crash. MKI's books show it was indebted to Mr. Kaplan and these distributions were recorded on its books as "repayments of loans due shareholders." There is no evidence, testimonial or otherwise, which indicates the debt was fictitious. Indeed, the record indicates the contrary. It shows Mr. Kaplan had made loans totaling $1.4 million to MKI. Because MKI was apparently insolvent when the $611,000 was paid to Mr. Kaplan, these withdrawals may be voidable or even void as fraudulent conveyances, but we do not think they justify piercing the corporate veil. We think the proponent of an alter ego theory must show more than shown here.

This record does not show that MKI was a "sham" either pre- or post-workout. Instead, it shows that Mr.

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28 A withdrawal during insolvency could be void or voidable as a fraudulent conveyance, but First Options has never relied on that theory.

Kaplan had run a successful business venture until the crash. From it, before and after the crash, he had sometimes withdrawn funds for personal use without observing corporate formalities. With the exception noted, none of these withdrawals appear to have affected MKI's solvency or to have been made when it was insolvent. This record does not clearly and convincingly show that MKI was a sham Mr. Kaplan manipulated in fraud of its creditors.

The district court's finding that MKI was Mr. Kaplan's alter ego does not withstand review when the correct standard of independent judicial review of an arbitration panel's decision on its own jurisdiction is substituted for the incorrect standard of manifest disregard for the evidence that the district court used. Applying the proper standard, we conclude the Exchange did not have jurisdiction over the dispute between Mr. Kaplan and First Options concerning his individual liability to perform all of MKI's obligations, under the workout or otherwise, on a theory that they were alter egos.

The evidence in this record is insufficient to allow First Options to pierce MKI's corporate veil.[29]

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29 We do not imply that the arbitrators exhibited a manifest disregard for the law when they concluded on the merits that Mr. Kaplan and MKI were alter egos. Indeed, we express no opinion whatsoever on that issue. Before reaching it, a court must decide independently whether the arbitrators have jurisdiction.



## VII.

The order of the district court confirming the arbitration award against the Kaplans will be reverse. The record will be remanded to the district court with instructions to enter in its place an order vacating the arbitrators' award against the Kaplans. The order confirming the award as to MKI will be affirmed.[30]

Each party shall bear its own costs.

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30 The only argument MKI asserts to vacate the arbitration award against it is the arbitrators' and arbitration process's bias in favor of First Options. It says this made their award fundamentally unfair in violation of 9 U.S.C.A. § 10(a)(2) (West Supp. 1993) *See* Brief for Appellants at 31. MKI alleges fourteen instances of such bias. In order to show "evident partiality," "the challenging party must show 'a reasonable person would have to conclude that the arbitrator was partial' to the other party to the arbitration." *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344. 1358 (6th Cir. 1989) (quotation omitted), *cert. denied*, 495 U.S. 947 (1990). "Evident partiality" is strong language and requires proof of circumstances "powerfully suggestive of bias." *Merit Ins. Co. v. Leatherby Inc. Co.*, 714 F.2d 673, 681-82 (7th Cir.). *cert. denied*, 464 U.S. 1009 (1933), *mandate modified*, F.2d 943 (7th Cir. 1984). After review of the record, we conclude that the instances MKI cites, taken together, do not show "evident partiality." The district court's order confirming the arbitration award against MKI will be affirmed for the reasons given by the district court.

**A True Copy:**
**Teste:**

***Clerk of the United States of Court***
***of Appeals***
***for the Third Circuit***



UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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No. 92-1814

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MANUEL KAPLAN; CAROL KAPLAN;
MK INVESTMENTS, INC.,
Appellants

v.

FIRST OPTIONS OF CHICAGO, INC.,
Appellee

---

Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action No. 92-00210)

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SUR PETITION FOR REHEARING

PRESENT: BECKER, STAPLETON, MANSMANN,
GREENBERG, HUTCHINSON, SCIRICA,
COWEN, NYGAARD, ALITO, ROTH and
LEWIS, Circuit Judges

The petition for rehearing filed by appellee in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the

other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

/s/ William D. Hutchinson
Circuit Judge

DATED: June 29, 1994



**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| **MANUEL KAPLAN, CAROL KAPLAN and MK INVESTMENTS, INC.,** | : | |
| **Petitioners and Cross-Respondents** | : | |
| **v.** | : | **NO. 92-MC-210** |
| **FIRST OPTIONS OF CHICAGO, INC.,** | : | |
| **Respondent and Cross-Petitioner.** | : | |

**MEMORANDUM**

**WALDMAN, J.** **September 25, 1992**

BACKGROUND

Manuel Kaplan, Carol Kaplan and MK Investments, Inc. ("MKI"), collectively, the petitioners, seek to vacate an arbitration award entered against them on June 5, 1992 by the Philadelphia Stock Exchange (the "Exchange"). The award was entered in the amount of $6,008,530, plus accrued interest, in favor of respondent, First Options of Chicago, Inc. ("First Options"). First Options has filed a cross-petition to confirm the award. An opportunity for hearing and argument was provided. The parties agreed that all necessary factual determinations could be made from the voluminous record submitted by them, including a

transcript of the arbitration proceedings. Moreover, the parties have stipulated to virtually all of the pertinent facts.

## FACTS

MKI, a Pennsylvania corporation, was an options market maker on the Exchange from the date of its incorporation in 1984 until January 1989. Tr. at 515.[1] MKI was the successor to MK Associates, Ltd. of which Manuel Kaplan had been the general partner. First Options has been MKI's clearinghouse and Manuel Kaplan has cleared through First Options since the early 1980's. Tr. at 25, 515.

Manuel Kaplan is the president of MKI and its sole shareholder since 1986. Five days before the stock market crash of October 19, 1987, MKI's trading account has a net equity of $10.5 million. Rec'd. at 220. On the day of the crash, MKI's trading account was decimated. On October 19, 1987, MKI's net equity was a negative $2.1 million. Id. at 221.

First Options decided that the large risk exposure and debit on the account necessitated its assuming control over the account and it did so. Tr. at 45. First Options proceeded to liquidate all positions held by MKI which

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[1] An options market-maker is an entity which trades options for its own account. The ability of a market maker to conduct trades is facilitated by a so-called "clearinghouse." A clearinghouse provides the market maker with administrative support, risk control services, and guarantees its account to other traders in exchange for commission compensation.



presented significant risks. Id. at 46-47, 50. First Options' actions were partially prompted by Mr. Kaplan's failure to cooperate with them. Id. at 45 (barricaded himself away from First Options' personnel); Id. at 47 (difficulty in communicating with him because he closed himself off from First Options' staff).[2] When the process was completed, the MKI account had a negative balance of about $5.1 million. Rec'd. at 13.

After an extended period of negotiations, the parties reached agreement for a work-out on the debt (the "Work-Out"). The Work-Out consists of four documents: (1) the Letter Agreement; (2) the Guaranty; (3) the Subordinated Loan Agreement; and, (4) the Subordinated Promissory Note. Stip. at ¶ 21. Each document was executed on March 24, 1988. Id. Under the terms of the Work-Out, the parties agreed to the following:

> MKI acknowledged the $5.1 million debt, as well as the $750,000 debt of another entity, and an additional $300,000 for a total indebtedness to First Options of $6,227,188;
>
> Manuel Kaplan paid First Options $80,000;

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[2] It also appears that Mr. Kaplan was uncooperative in the effort to liquidate the MKI account. Rec'd. at 147 (noting that he was unavailable, refused to communicate, was particularly difficult to deal with, and that staff members in the office found him objectionable and threatening).

MKI agreed to transfer ownership of four Exchange memberships to First Options;

a $900,000 Trading Account with First Options was created, $500,000 of which was designated the "MK Allocation" and $400,000 was designated the "FOC Allocation";

Manuel Kaplan and his wife Carol Kaplan agreed to give First Options their 1987 tax refund upon receipt -- an amount specified to be at least $300,000; and,

> MKI would provide First Options with an agreed percentage of its profits.

Rec'd. at 13-20.

The parties also executed releases. Upon satisfaction of its obligations under the Work-Out agreement, MKI would be released from its indebtedness obligations. First Options executed a release in favor of Manuel Kaplan which clearly provided that he was not released "from complete performance of the terms of this Agreement and other documents contained herein and applicable to them." Id. at 24-25.

Pursuant to the provisions of the Work-Out, MKI renewed its trading in April 1988. Tr. at 60. On January



16, 1989, the position of the MKI trading account again suffered a serious loss as a result of a takeover. Id. at 30, 201. First Options, believing MKI's position was precarious, was concerned that no responsive action was taken and about Mr. Kaplan's stability. Id. at 30-33, 201-202.[3] First Options decided to take over the account. Id. at 33, 35, 223. First Options barred MKI and Manuel Kaplan from conducting further business on the premises and ordered all MKI traders off the trading floor. Id. at 34-35; 222. First Options liquidated all positions in the trading account over a period of four months. Id. at 226. The account yielded a final deficit of about $65,000. Id. at 229.

Thereafter, pursuant to the terms of the Work-Out, First Options sent letters to MKI and the Kaplans demanding that MKI open its books and records for inspection and that the Kaplans honor their agreement to turn over their 1987 tax refund. When the Kaplans did not comply, First Options declared an acceleration under the Work-Out and demanded immediate repayment of the entire debt. Rec'd. at 192-95.

In June 1989, about one month later, First Options submitted this matter to the Exchange for arbitration. MKI and Manuel Kaplan counterclaimed for breach of contract, interference with prospective business opportunity and

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3 First Options had set up a meeting with Mr. Kaplan at 8:00 a.m. the following morning. Tr. at 201. He did not show up and First Options was unable to reach him. Id. at 202. When he finally arrived at 11:00 a.m., First Options found his answers unresponsive to their concerns. Id. at 31-33, 203.

defamation. Each sought damages from First Options in the amount of $10 million.

A seven member arbitration panel heard eight days of testimony between May 7 and May 28, 1992. On June 5, 1992, the panel entered the following award:

> (1) against Manuel Kaplan and MKI, jointly and severally, in the amount of $5,662,188.00, plus interest;
>
> (2) against Manuel Kaplan and Carol Kaplan, jointly and severally, in the amount of $346,342.00, plus interest; and,
>
> (3) against Manuel Kaplan and MKI on their counterclaims.

DISCUSSION

The law is well-established that the "court's function in confirming or vacating a commercial [arbitration] award is severely limited." See Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance Co., Ltd., 868 F.2d 52, 56 (3d Cir. 1989). The Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, et seq., generally sets forth the principles governing a district court's authority to confirm or vacate an arbitration award. Title 9 U.S.C. § 9 provides:

> at any time within one year after the [arbitration] award is made any party to the arbitration may apply to the court . . . for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title . . . . [S]uch application may be made to the United States court in and for the district within which such award was made.



Confirmation "is a summary proceeding that merely makes what is already a final arbitration award a judgment of the court." Florasynth, Inc. v. Pickholz, 750 F.2d 171, 176 (2d Cir. 1984) (citing M. Domke, The Law and Practice of Commercial Arbitration, § 37.02 (1968)). See also Air Line Pilots Ass'n Int'l v. Aviation Associates Inc., 955 F.2d 90, 93 (1st Cir. 1992) ("ordinary analysis of motions under Fed. R. Civ. P. 56 is not particularly helpful because the enforcement proceeding is by nature summary."), cert. denied, 112 S. Ct. 3036 (1992); Taylor v. Nelson, 788 F.2d 220, 225 (4th Cir. 1986) ("A confirmation proceeding under 9 U.S.C. § 9 is intended to be summary: confirmation can only be denied if an award has been corrected, vacated, or modified in accordance with the Federal Arbitration Act.").[4] Absent grounds to vacate or modify the award in this case, it must be confirmed.

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[4] An unconfirmed award is not invalid. Indeed, a majority of awards are not confirmed. Pickholz, 750 F.2d at 176. "A party, successful in arbitration, seeks confirmation by a court generally because he fears the losing party will not abide by the award." Id.

A party challenging an award must establish that:

(1) the award was procured by corruption, fraud or undue means;

(2) there was evident partiality or corruption of the arbitrators;

(3) the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or any other misbehavior by which the rights of any party have been prejudiced; or,

(4) the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made.

9 U.S.C. § 10(a) (1)-(4).[5]

An award may also be set aside if it results from a decision reached in manifest disregard of law. See Cart Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd., 888 F.2d 260, 265 (2d Cir. 1989) (manifest disregard of law

[5] Prior to amendment in 1990, these provisions were designated as subsections (a)-(d) and referred to as such in several pertinent pre-amendment court opinions cited herein.



is judicially-created ground for vacating an arbitration award); Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933-34 (2d Cir. 1986) (same); Sheet Metal Workers Int'l Assoc. v. Kinney Air Conditioning Co., 756 F.2d 742, 746 (9th Cir. 1985) (same).

In support of vacatur, petitioners assert four grounds:

(1) the arbitration panel lacked jurisdiction over the individual parties, Manuel and Carol Kaplan;

(2) the arbitrators were biased in favor of First Options;

(3) the panel's decision reflects manifest disregard of the law;

(4) the award is fundamentally flawed as it was signed only by the Chairperson of the panel.

**A. Jurisdiction of the Panel over the Kaplans**

Pursuant to 9 U.S.C. § 10(a)(4), petitioners contend that the arbitration panel "exceeded its powers" since Manuel and Carol Kaplan, as individuals, did not agree to arbitrate this dispute with First Options. Generally, courts read § 10(a) (4) quite narrowly. See, e.g., Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512, 515 (2d Cir.) ("We have consistently accorded the narrowest reading to section 10(d) . . . ."), cert. denied, 112 S. Ct. 3801 (1991), and cert.

denied, 112 S. Ct. 1241 (1991); Andros Compania Maritiam v. Marc Rich & Co., A.G., 579 F.2d 691, 703 (2d Cir. 1978) ("We have consistently accorded the narrowest of readings to the Arbitration Act's authorization to vacate awards 'where the arbitrators exceeded their powers.'"). An award may be vacated if the form of the award cannot rationally be derived from the agreement between the parties or from the parties' submissions to the arbitrators. See Norad Reinsurance Co., 868 F.2d at 56. A court reviewing an arbitration award under § 10(a) (4) shall not "sit as the panel did and reexamine the evidence under the guise of determining whether the arbitrators exceeded their powers." Id.[6]

Individual petitioners' contention that the panel exceeded its authority in exercising jurisdiction over them as they did not consent to the arbitration is premised on the absence of their signature on any document containing an arbitration clause.

The Work-out agreement consists of four documents each dated March 24, 1988. Rec'd. at 13-33; 44-50. The documents are (1) the Letter Agreement; (2) the Guaranty; (3) the Subordinated Loan Agreement; and (4) the Subordinated Promissory Note. Only the Subordinated Loan Agreement contains an arbitration provision and the

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[6] Despite interpretations to the contrary, the court notes that the express language of § 10(a) (4) is more applicable to situations where it is merely unclear that a final and definite award was reached. See International Longshoremen's Assoc. v. West Gulf Maritime Assoc., 594 F. Supp. 670, 677 (S.D.N.Y. 1984).



Kaplans, as individuals, signed only the Letter Agreement which obligated them to provide First Options with their personal income tax refund for 1987. Stip. at ¶ 21; Rec'd. at 27, 47.

The court finds persuasive the reasoning in Com-Tech Associates v. Computer Associates Int'l, Inc., 753 F. Supp. 1078 (E.D.N.Y. 1990), aff'd, 938 F.2d 1574 (2d Cir. 1991). In that case, the parties contested whether they were required to arbitrate their dispute. Although they agreed to arbitrate disputes arising under one agreement, the dispute in question arose under another agreement which did not have an arbitration clause. The terms of the arbitration provision in the one agreement were held to encompass the dispute arising under the other agreement. The parties had executed the agreements in question at or about the same time, and the agreement which was silent on arbitration was referred to in the agreement with the arbitration clause. The Court concluded:

> Although the Marketing Agreement itself fails to specifically provide for arbitration, the circumstances of this case, the relationship of the parties and the strong federal policy favoring arbitration compels the Court to conclude that this dispute arising out of the Marketing Agreement is also subject to arbitration . . . . Based on the totality of circumstances, coupled with the strong federal policy favoring

> arbitration, the Court finds that the Partnership Agreement, which governs the rights and obligations of the parties . . . constituted an "umbrella" for both the System and Marketing Agreements, since all three agreements are interrelated and dependent on each other.

Id. at 1084 (citations omitted).

In the instant case, the facts supporting a similar construction of the parties' agreements are even more compelling. The arbitration provision in the Subordinated Loan Agreement, executed the same day as the Letter Agreement, expressly incorporates the Letter Agreement. It states, in pertinent part:

> any controversy arising out of or relating to this Agreement, the Letter Agreement, the Subordinated Notes or any other document referred to herein or therein or the breach thereof shall be submitted to and settled by arbitration pursuant to the Constitution and Rules of the Exchange. The parties hereto and all who may claim under them shall be conclusively bound by such arbitration.

Rec'd. at 47, ¶ 10 (emphasis added).

Further, the Subordinated Loan Agreement states: "this Agreement [the Subordinated Loan Agreement], the



Letter Agreement, the Subordinated Notes, and any documents referred to herein or therein embody the entire agreement between the parties . . . ." Id. at 48, ¶ 14. The Subordinated Loan Agreement also obligates MKI to "pay to FOC [First Options] or its assigns the amount of the Total Indebtedness subject to that certain Letter Agreement dated March 24, 1988 (the "Letter Agreement") from the borrowers and the other parties thereto and FOC, which is incorporated herein and made a part hereof." Id. at 44. The Subordinated Loan Agreement has references to the Letter Agreement throughout. Similarly, the Letter Agreement has numerous references to the Subordinated Loan Agreement. Id. at 13, 14, 15, 17, 21, 27. Indeed, the Letter Agreement provides that the Kaplans' failure to satisfy timely their personal obligation could constitute an "Event of Acceleration." Id. at 15. An "Event of Acceleration," is not defined in the Letter Agreement but is defined in the Subordinated Loan Agreement. Id. at 48 ("any material breach of or failure to perform any covenant made by any Borrower in connection with the execution of this Agreement, the Letter Agreement, . . . or any other document referred to therein or herein").

The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration, see Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983), the court concludes that pursuant to the

arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans.

Moreover, any objection petitioners may have had to the authority of the arbitrators was waived. It is well-established that a party who voluntarily and unreservedly submits an issue to arbitration cannot later maintain that the arbitrators acted without authority to resolve that issue. See Pennsylvania Power Company v. Local Union No. 272 of Int'l Broth. of Elec. Workers, 886 F.2d 46, 50 (3d Cir. 1989) (citing Teamsters Local Union v. J.H. Merritt & Co., 770 F.2d 40, 42 (3d Cir. 1985), cert. denied, 474 U.S. 845 (1985)); Jones Dairy Farm v. Local No. P-1236, United Food and Commercial Workers International Union, 760 F.2d 173, 175 (7th Cir. 1985). It has been held that a party cannot contest the jurisdiction of an arbitration panel, submit the question to the panel and subsequently move to vacate an adverse award for lack of jurisdiction. See Orion Pictures Corp. v. Writers Guild of America, West, Inc., 946 F.2d 722, 725 (9th Cir. 1991) (party challenging jurisdiction had "gone too far down the slippery slope in submitting its dispute to arbitration" and waived its right to de novo judicial review.) See also Ferndale Corp. v. Schulman Urban Development Assoc., 758 F. Supp. 861, 867 (S.D.N.Y. 1990) ("Once a party [contesting jurisdiction] receives notice of his adversary's intention to arbitrate, the proper procedure is to make application by special proceeding to stay arbitration."); Halley Optical v. Jaga Int'l Marketing Corp., 752 F. Supp. 638, 639 (S.D.N.Y. 1990).



In Halley Optical, an arbitration panel entered an award against a corporation and its president. The president moved to vacate the award against him in his personal capacity on the ground that he was not party to the agreement containing the arbitration clause. He contested before the arbitrators whether the arbitration clause applied to him, but did not move for a stay. The court concluded that he waived judicial review of jurisdictional objections to the arbitration. The Court stated:

> To find otherwise would allow a party to participate in an arbitration, with the assurance that if it loses it may later challenge whether it had ever agreed to arbitration. Such a result is contrary to the clear policy favoring arbitration.

Id. at 639-40.

The standard for waiver in the Third Circuit requires a clear indication by a party of his willingness to forego judicial review. Pennsylvania Power, 886 F.2d at 50 (citing Local 719, American Bakery & Confectionery Workers of America v. National Biscuit Co., 378 F.2d 918, 921-22 (3d Cir. 1967)). In the instant case, petitioners clearly indicated their willingness to submit to the authority of the arbitration panel and forego any jurisdictional objections.

At a pre-hearing conference on February 26, 1990, the Kaplans voluntarily withdrew jurisdiction objections previously filed, and participated in a discovery conference which was an integral part of the arbitration proceedings.

Stip. at ¶ 5. The panel thereafter rendered decisions pertaining to the parties' various discovery requests, preliminary objections and motions. Stip. at ¶ 6; Rec'd. at 130. There was no need or logical reason for the panel to address the Kaplans' initial objection to jurisdiction as that objection had been withdrawn. Only in January 1992, two and one-half years after the arbitration process had commenced and two years after withdrawing jurisdictional objections, did the Kaplans file a motion to dismiss for lack of jurisdiction. See Stip., ¶¶ 9,11. The motion was denied on January 14, 1992. Stip., ¶ 12.

A finding of waiver is entirely consistent with the cases relied on by petitioner, none of which presented facts remotely similar to those in the instant case. In one, the party challenging the jurisdiction of the arbitrator expressly reserved his right to judicial review and stated at the opening of the proceeding that it would not recognize the validity of the arbitrator's decision. National Biscuit Co., 378 F.2d at 921. In the other, the party challenging arbitrability "repeatedly" raised an objection and "consistently" maintained its position. Pennsylvania Power, 886 F.2d at 50.[7]

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[7] Petitioners also cite a footnote in International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Local 249 v. Western Pennsylvania Motor Carriers Ass'n, 574 F.2d 783, 786 n.2 (3d Cir. 1978), cert. denied, 439 U.S. 828 (1978) for the proposition that proceeding on the merits before an arbitrator does not constitute waiver. The footnote cites National Biscuit which is factually distinguishable and the facts pertinent to the waiver question



In contrast, the Kaplans neither expressly reserved nor consistently maintained an objection to the arbitration panel's jurisdiction. Rather, they withdrew a jurisdiction objection and for two years, while the arbitration process ensued, expressed no unwillingness to abide by the arbitrators' decision. See Yorkaire, Inc. v. Sheet Metal Workers, Local 19, 758 F. Supp. 248, 253 (E.D. Pa. 1990), aff'd mem, 931, F.2d 53 (3d Cir. 1991) (party waives right to judicial review where he submits jurisdictional questions to arbitrator and does not indicate unwillingness to be bound by decision).

Clearly, at some point in the arbitration process, a party can no longer be allowed to change his position about his acceptance of an arbitrator's jurisdiction. Otherwise, a party could raise such objections whenever a ruling is made or the process unfolds contrary to his expectations or interests. A party reasonably cannot "reverse course" about an arbitration panel's jurisdiction once the arbitration process has commenced and matters pertinent to the arbitration have been litigated and ruled upon.

There is another compelling fact in the instant case. Manuel Kaplan submitted counterclaims in this matter to the panel which were never withdrawn. In fact, a motion by First Options to dismiss those counterclaims was denied on February 27, 1990, at the very time Mr. Kaplan withdrew his jurisdictional objection. This action also

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in International Brotherhood cannot otherwise be gleaned from the opinion.

manifests a clear acceptance of the arbitration panel's authority.

Where a party has waived jurisdictional objections, the court reviews a decision to exercise jurisdiction like any other arbitration decision only for a manifest disregard of law. See Yorkaire, Inc., 758 F. Supp. at 255. As discussed above, the court concludes that even under a de novo review, the panel properly exercised jurisdiction. Accordingly, the arbitrators' decision to exercise jurisdiction would not be in manifest disregard of the law.

**B. Alleged Bias of the Panel**

To invalidate an award for "evident partiality" pursuant to § 10(a) (2), "the challenging part must show that 'a reasonable person would have to conclude that the arbitrator was partial' to the other party to the arbitration." See Apperson v. Fleet Carrier Corp., 879 F.2d 1344, 1358 (6th Cir. 1989) (quoting Morelite Const. Corp. v. New York City District Council Carpenters Benefit Fund, 748 F.2d 79, 84 (2d Cir. 1984)), cert. denied, 495 U.S. 947 (1990)). "Evident partiality" is "strong language" and requires proof of circumstances "powerfully suggestive of bias." Merit Ins. Co. v. Leatherby Ins. Co., 714 F.2d 673, 681-82 (7th Cir.), cert. denied. 464 U.S. 1009 (1983), mandate modified, 728 F.2d 943 (7th Cir. 1984). See also Lascho Ins. v. Erickson, 700 F. Supp. 960 (N.D. Ill. 1988) (denial of petitioner's discovery request, refusal to impose sanctions on respondent, misapplication of law and refusal to consider new evidence after close of hearing insufficient to establish partiality). The burden to prove such



circumstances rests squarely upon the party challenging the award. Sheet Metal Workers Int'l Assoc., 756 F.2d at 745.

Petitioners cite fourteen instances which they allege collectively substantiate bias.

**1. The Vacation of a Discovery Order**

On February 26, 1990, the Arbitration Committee, from which the panel was drawn, denied First Options' request for certain discovery materials concerning MKI's corporate activities predating the Work-Out. Stip. at ¶ 22. One member of the Committee who participated was Michael Waber, a business associate of Manuel Kaplan. Id. at 23-24. The seven panel members subsequently chosen to take testimony reviewed the initial decision and vacated it.[8]

Petitioners do not request review of the merits of the panel's amended discovery order, but merely assert that the reconsideration of the previous order was "fundamentally unfair." See Pets.' Br. at 27. The participation of an associate of Mr. Kaplan provided a reasonable basis for the panel's reconsideration of the prior discovery order.

**2. Release of Morgan Stanley Transcript**

First Options requested access to a transcript of an unrelated arbitration proceeding conducted by the Exchange involving MKI and Morgan Stanley. Stip. at ¶

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[8] The Committee is comprised of at least eleven members but only a quorum is required for it to act. First Options' were unaware that Mr. Waber had participated until December 1991.

31. Petitioners objected and the request was denied on October 4, 1989. Stip. at ¶¶ 32-33. Subsequently, Morgan Stanley requested and obtained the record of its proceeding from the Exchange and provided it to First Options. Id. at ¶¶ 33-35.

That Morgan Stanley procured the record of an arbitration proceeding in which it was a party and then shared it with First Options does not demonstrate that the panel in this case was biased.

**3. Discovery Ruling**

First Options' objection to a discovery request by petitioners regarding First Options' piercing-the-veil theory as "contention" interrogatories was sustained. Id. at ¶ 37. First Options had interrogatories stricken for the same reason. Id. It is not error to deny discovery requests related to legal theories and, in any event, the panel's denial of comparable requests by all parties does not demonstrates bias.

**4. Admission of Typed Summaries**

Nine typewritten documents relating to the subject of the testimony of an accountant for First Options were admitted into evidence. Id. at ¶ 43; Tr. 381-431. Counsel for First Options had contacted the Director of Arbitration for the Exchange to confirm that it did not require that summaries, compilations and analyses be produced prior to an arbitration hearing. Stip. at ¶ 44.



Petitioners contend that the summaries were improperly admitted on the basis of a pre-hearing ex parte ruling by the Director of Arbitration. While it would be advisable for the Exchange promptly to acquaint all parties with the pertinent procedural rules of its arbitration program without waiting for specific inquiries, the Director did not render a "ruling" and would not have the power to do so. The panel's decision to admit summaries prepared by the accountant-witness does not demonstrate bias.

**5. and 6. Mr. Windus' Rebuttal Testimony**

Petitioners contend that in allowing the "rebuttal testimony" of Mr. Gary Windus and restricting examination of the witness, the panel was fundamentally unfair. First Options sought permission to call Mr. Windus in rebuttal. The witness had been subjected to extensive prior examination by both parties. The panel, after deliberation, decided to allow him to give rebuttal testimony limited to several narrow points deemed appropriate and posed three questions designed by the panel to elicit succinctly the pertinent information. Tr. at 894-95. The panel stated:

> Gentlemen, after deep discussion we have agreed to allow Mr. Windus to testify . . . . We are going to ask the questions. We have outlined three questions that we will ask Mr. Windus and that will be it. O.K.

The panel asked the questions and neither party was allowed to engage in further examination. This decision

does not demonstrate bias. Indeed, in response to the panel's proposal, counsel for petitioners stated: "If we'd done this with every other witness it would be a lot easier." Id.

**7. Closing Arguments**

Petitioners requested two hours for closing arguments. Stip. at ¶ 51. The panel granted twenty minutes to each side and then extended that time to forty minutes for each party. Id. at ¶ 52. The panel denied petitioners' request for rebuttal argument. Id. at ¶ 47.

Petitioners contend that as a result, counsel for First Options was able to make an unrebutted reference to material outside the record in his closing argument. Petitioners specify only one isolated oblique comment: "First Options did want a lot [in the workout negotiations]. I was around back then. I know they wanted a lot." There is no basis to conclude that the arbitrators failed to appreciate the distinction between testimony and arguments of counsel, and no suggestion that petitioners' counsel was deprived of the ability to register an objection to this comment as referring to a matter beyond the record. The panel's procedures regarding closing arguments does not demonstrate bias.

**8. Testimony by Telephone**

The panel ruled on April 30, 1992 that "any witness" could testify by telephone. Id. at ¶ 13 (emphasis added). Three witnesses for First Options so testified. Id.



at ¶ 53. There is no suggestion that petitioners ever sought to introduce any testimony by telephone or were deprived of the opportunity to do so. That the panel offered both sides the opportunity to have witnesses testify by telephone and only one party utilized that procedure does not demonstrate bias.

**9. Refusal to Pursue Allegation of Witness Tampering**

At the beginning of the proceeding, counsel disputed the propriety of a subpoena issued to Seymour Specter, an employee of Bear Stearns & Co. Supp. at ¶¶ 1-2. He was to have been an expert witness for petitioners but they voluntarily withdrew his name and subpoena. Id. First Options called as an expert, Scott Talento, another employee of Bear Stearns & Co. Id. Counsel for petitioners sought to ask Mr. Talento whether someone at Bear Sterns had told Mr. Specter not to testify for petitioners and an objection was sustained. Petitioners were entitled to call Mr. Specter as a witness and ask him about any relevant matter about which he was competent to testify. They decided not to do so. The decision to sustain objections to questions about what may have been communicated to an individual other than the witness was not inappropriate and does not demonstrate bias.

**10. Transcription of Testimony**

Late in the proceedings, First Options asked the Director of Arbitration to transcribe one day of Manuel Kaplan's testimony. Stip. at ¶ 54. She transcribed the

testimony, sent both parties a copy and indicated that she would not make further transcriptions due to the burdens related thereto. Id. at ¶ 55. Petitioners never asked the Exchange to transcribe any testimony and did not object to the decision to refrain from transcribing further testimony. Stip. at ¶ 58.

This occurrence in no way demonstrates bias or partiality.

**11. Insensitivity to Religious Practice**

The preliminary scheduling of this arbitration included Saturday hearing dates. Id. at ¶ 59. When rescheduled for April 1992, counsel for petitioner requested that no Saturday hearings be held because of his religious practices. Id. at ¶ 60. Ultimately, the hearings were rescheduled to May 1992, and there were no Saturday proceedings. Id. at ¶ 61. Citing religious practice, Manuel Kaplan objected to Friday sessions extending beyond 7:30 p.m. That request was denied. Id. at ¶ 62.

Petitioners contend that the refusal to accommodate Mr. Kaplan's religious practice demonstrates bias. The parties agree that members of the panel are individuals who otherwise hold full-time employment in the securities industry and thus all hearings were held in the evenings. The record indicates that scheduling these hearings had repeatedly presented difficulty for all concerned. There is no suggestion that the panel accommodated any comparable request by persons associated with First Options or that Mr. Kaplan's case would have been



prejudiced by his early departure on a Friday. Nevertheless, the court believes that absent a very compelling reason to the contrary, it would be desirable for the Exchange to accommodate requests such as Mr. Kaplan's. Its failure to do so in the context of the record adduced, however, does not demonstrate bias regarding the merits of the parties' positions.

**12. Evidentiary Rulings**

Petitioners contend that four evidentiary rulings during the proceedings can only be explained by partiality: (1) the disallowance of certain rebuttal testimony; (2) disallowing testimony on hearsay grounds; (3) allowing testimony on an issue a witness refused to address at a deposition; and, (4) not allowing cross-examination of a witness on a point regarding Mr. Kaplan's purported use of an "unapproved" broker. The Court has reviewed each ruling. They were well within the discretion accorded the panel in conducting its proceedings and do not demonstrate bias.

**13. Refusal to Allow Time for Consultation**

As noted, Scott Talento was an expert witness on behalf of First Options. Counsel for petitioners asked for a moment to consult before commencing cross-examination. The request was denied. In the absence of evidence that this was a routine practice applied only to petitioners, the Court cannot conclude that the panel was biased based on this ruling.

**14. Choice of Language**

Petitioners contend that on two occasions the panel's "own words revealed their biases." On the first, the panel Chairperson asked Larry Goldberg, a friend and business colleague of Manuel Kaplan's, whether he had been present in his office on January 16-17, 1989, when that question was not posed during cross-examination. This was a valid and pertinent question from a member of the panel and does not demonstrate bias. On the other occasion, counsel for petitioners was attempting to elicit testimony that the Chief Executive Officer of First Options "lost his cool" on January 17, 1989, after the MKI account had suffered another serious loss. The panel instructed counsel to move on stating: "We recognize how upset a person can be in a situation like that." This does not substantiate a claim of bias.

Able and energetic counsel for petitioners have combed through the voluminous record to extract and string together every instance which one conceivably could argue might be suggestive of partiality. Even taken together, in the context of the proceedings, the instances cited by the petitioners do not remotely satisfy the stringent standard for proving "evident partiality."



**C. Manifest Disregard of Law**

An award may also be vacated if a panel acted in manifest disregard of the law. "Manifest disregard of law" is a judicially-created ground for vacating an arbitration award. Carte Blanche (Singapore) Pte., Ltd., 888 F.2d at 265; Sheet Metal Workers Int'l Assoc., 756 F.2d at 746. Manifest disregard has been defined as more than a legal error or misunderstanding of the law. "The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator." Merrill, Lynch, 808 F.2d at 933-34. An award is not subject to revision unless its terms are "completely irrational." Norad Reinsurance Co., 868 F.2d at 56.

Petitioners contend that the arbitrators' decision to pierce the corporate veil and find Manuel Kaplan personally liable, jointly and severally with MKI, was in manifest disregard of law. It is well-established that the separate and distinct status of a corporate entity may be disregarded to prevent "fraud, illegality, injustice, or when recognition of the corporate entity would defeat public policy or shield someone from liability for a crime." Zubik v. Zubik, 384 F.2d 267, 271-274 (3d Cir. 1967), cert. denied, 390 U.S. 988 (1968). See also United States v. Pisani, 646 F.2d 83, 88 (3d Cir. 1981). Under the alter ego theory, the corporate veil may be pierced upon a showing of such things as:

> (1) gross undercapitalization for its purposes; (2) failure to observe corporate formalities; (3) non-payment of

> dividends; (4) insolvency of the debtor corporation at the time; (5) siphoning of funds of the corporation by the dominant shareholder; (6) non-functioning of other officers and directors; (7) absence of corporate records; or, (8) the fact that the corporation is merely a facade for the operations of the dominant shareholder.

Pisani, 646 F.2d at 88 (citing DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 686-87 (4th Cir. 1976)).

The arbitrators' heard considerable testimony regarding the commingling of Mr. Kaplan's personal funds with those of MKI. See, e.g., Tr. at 396-99. This included testimony of transactions in 1986 and 1987 in which:

> a withdrawal of $350,000 was made from the MKI trading account and a deposit into Manuel Kaplan's person checking account of $361,000 was made the same day;
>
> a check was drawn on the MKI trading account which related to the purchase of a house by Mr. Kaplan;
>
> Mr. Kaplan wrote a check for $1.4 million from his personal checking account to cover a margin call that



> required the deposit of a similar sum into MKI's trading account; and,
>
> a withdrawal of $125,000 was made from the MKI trading account, the funds were deposited two days later in Mr., Kaplan's personal checking account and shortly thereafter checks totaling $125,000 were written on that account to pay Mr. Kaplan's personal federal and state income taxes.

There was also other evidence that Mr. Kaplan disregarded corporate formalities and siphoned corporate funds. Manuel Kaplan was the sole shareholder of MKI. Stip. at ¶ 19. Despite the insolvency of MKI, $611,000 in checks were drawn in his favor from the corporate account in the eight weeks following the crash. Tr. at 401-02; Supp. at 1.[9] An accountant testified that in the period from February 1986 until January 1989, Manuel Kaplan removed from the corporate account and used for personal purposes, within forty-eight hours thereof, a total of $4.5 million. Tr. at 399. The accountant also gave a professional opinion that these transactions indicated a commingling of corporate and personal funds, and a personal use by Mr. Kaplan of funds which belonged to the corporation and its creditors. Id. at 400.

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[9] One check for $4,000 was made payable to cash but endorsed and cashed by Mr. Kaplan.

It also appears that Mr. Kaplan may have used a deceptive financing scheme to raise the $500,000 MKI allocation pursuant to the Work-Out and misrepresented the source of that money. Id. at 411-12; Supp. at 2.

There is ample support in the record for the arbitrators' decision to pierce the corporate veil in this case.

Petitioners contend that in any event First Options had unconditionally released Manuel Kaplan from any liability for the debt in the Work-Out. Even if this were so, it would not release MKI from liability for the debt and, on the record adduced, would not preclude a piercing of the corporate veil. More importantly, there was not an unconditional release of Manuel Kaplan. The release provision in the Letter Agreement (Rec'd at 25, ¶ 11) is expressly contingent upon his "complete performance of the terms of this Agreement and other documents contained herein and applicable to them."

It cannot be said that the arbitration panel's decision to pierce the corporate veil was a decision made in manifest disregard of the law.[10]

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10 The Court agrees with petitioners that it appears that the arbitrators enforced the terms of the work-out agreement. As it reasonably appears that Mr. Kaplan failed to comply with his obligations under the Work-Out, the release by its terms was ineffectual. Thus, First Options' argument that his breach released them from any obligations imposed by the Work-Out, including the release, is superfluous.



**D. The Arbitration Award is Fundamentally Flawed**

It is averred that the arbitration award cannot be enforced because the award was not signed by every arbitrator concurring in the award but rather only by the Chairperson. It is uncontroverted that the arbitration panel voted 5-2 in support of the award rendered. Stip. at ¶ 68. While this practice of the exchange may be less than desirable,[11] in the absence of any evidence whatsoever that the award was not in fact the judgment and decision of a majority of the members of the panel, it is insufficient to justify vacatur.

CONCLUSION

The documents constituting the work-out agreement were executed in tandem and are interdependent. Particularly given the underlying circumstances and the relationship of the parties, they must be read as a whole. The Subordinated Loan Agreement contains an arbitration provision and expressly incorporates the Letter Agreement signed by the Kaplans. This provides a legitimate basis for the exercise of jurisdiction by the arbitrators. Moreover, by expressly withdrawing a jurisdictional objection and then litigating matters integral to the arbitration process, and in the case of Mr. Kaplan submitting and litigating counterclaims, any jurisdictional objections were waived by petitioners.

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11 See Exchange Rule 950 § 37(a).

Petitioners have failed to demonstrate that the arbitrators were guilty of evident partiality. Indeed, many of the instances cited to substantiate a claim of bias demonstrate that the parties were treated similarly and even-handedly.

The arbitrators did not engage in a manifest disregard of the law. There was ample evidence of the commingling and siphoning of funds by Mr. Kaplan, and of his disregard of corporate formalities to justify the decision of the arbitrators to pierce the MKI corporate veil to prevent an injustice.

There are no grounds to vacate or modify the arbitrators' award in this case. Accordingly, the petition to vacate the award will be denied and the cross-petition to confirm the award will be granted. Appropriate orders will be entered.



**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| **MANUEL KAPLAN,** | : | |
| **CAROL KAPLAN** | : | **CIVIL ACTION** |
| **and MK INVESTMENTS, INC.** | : | |
| | : | |
| **Petitioners and Cross-respondents** | : | |
| | : | |
| **v.** | : | **NO. 92-MC-210** |
| | : | |
| **FIRST OPTIONS OF CHICAGO, INC.** | : | |

**O R D E R**

AND NOW, this 25th day of September, 1992, upon consideration of the Petition to Vacate Arbitration Award of Manuel Kaplan, Carol Kaplan and MK Investments, Inc. and the response of respondent First Options of Chicago, Inc. thereto and following an opportunity for a hearing and argument thereon, consistent with the accompanying memorandum, IT IS HEREBY ORDERED that the Petition is DENIED.

**BY THE COURT:**

/s/ _____

**JAY C. WALDMAN, J.**

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| **MANUEL KAPLAN,** | : | |
| **CAROL KAPLAN** | : | **CIVIL ACTION** |
| **and MK INVESTMENTS, INC.** | : | |
| | : | |
| **Petitioners and Cross-respondents** | : | |
| | : | |
| **v.** | : | **NO. 92-MC-210** |
| | : | |
| **FIRST OPTIONS OF CHICAGO, INC.** | : | |

**O R D E R**

**AND NOW,** this 25th day of September, 1992, upon consideration of the Cross-Petition of First Options of Chicago, Inc. for Confirmation of Arbitration Award and Entry of Judgment and the response of cross-respondents thereto and following an opportunity for a hearing and argument thereon, consistent with the accompanying memorandum, **IT IS HEREBY ORDERED** that the Cross-Petition is **GRANTED** and accordingly **JUDGMENT IS ENTERED** in favor of First Options of Chicago, Inc. and against MK Investments, Inc. and Manuel Kaplan, jointly and severally, in the amount of $5,662,188, plus interest at the rate of 6% from January 17, 1989 to date, and in favor of First Options of Chicago, Inc.



and against Manuel Kaplan and Carol Kaplan in the amount of $346,342, plus interest at the rate of 6% from January 17, 1989 to date.

**BY THE COURT:**

/s/ _____

**JAY C. WALDMAN, J.**

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| **MANUEL KAPLAN,** | : | |
| **CAROL KAPLAN** | : | **CIVIL ACTION** |
| **and MK INVESTMENTS, INC.** | : | |
| | : | |
| **Petitioners and Cross-respondents** | : | |
| | : | |
| **v.** | : | **NO. 92-MC-210** |
| | : | |
| **FIRST OPTIONS OF CHICAGO, INC.** | : | |

**ORDER**

**AND NOW,** this 25th day of September, 1992, upon consideration of the Motion for a Preliminary Injunction of First Options of Chicago, Inc. and the response thereto, **IT IS HEREBY ORDERED** that said Motion is **DENIED** as moot.

**BY THE COURT:**

/s/_____

**JAY C. WALDMAN, J.**